Comprehensive social security in South Africa

Discussion document

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1 Social security reform: an overview

1.1 Introduction

South Africa has made good progress in broadening social assistance and expanding health care and social insurance since 1994. However, there is still more to be done if the social security system is to fully meet its Constitutional requirements.

In 2007, Cabinet appointed an Inter-Ministerial Committee (IMC) to make recommendations for reforming the social security system. The IMC appointed an Inter-departmental Task Team on Social Security and Retirement Reform (IDTT) to provide technical advice and make recommendations for consideration by Cabinet. This report summarises the IDTT's findings and offers extensive proposals for reforming and improving social security delivery.

The most notable gap in our social security system is the absence of a public fund that provides pensions and life insurance to the workforce as a whole. A large number of private occupational and voluntary schemes have been established to fill this gap, but some 2.7 million formal sector workers[1] – primarily low-income earners – are excluded from such arrangements.

The IDTT's principal reform proposal is therefore the establishment of a National Social Security Fund (NSSF), which will be financed by contributions from workers and employers and will pay pensions, disability and survivor benefits, and unemployment benefits.

It is also proposed that the introduction of the NSSF be accompanied by measures to address the following deficiencies in existing social security institutions:

(1) Social assistance does not reach all intended targets, and its cash payment systems are expensive.

(2) There is insufficient policy coordination between social insurance funds such as the Unemployment Insurance Fund, workers' compensation schemes and the Road Accident Fund. The funds also have separate systems and administration, resulting in high costs and increasing the scope for fraudulent claims.

(3) Members of private retirement funds rarely receive a sufficient income in retirement, in part because they do not preserve their savings throughout their career and in part because their savings are eroded by high administrative costs.

(4) There is a lack of coherence between social security arrangements and the labour market. Social security recipients should be encouraged and enabled to return to the labour force at the earliest opportunity via public employment institutions, active labour market policies and skills development programmes.

(5) The Road Accident Fund and the workers' compensation schemes need to adapt their arrangements in light of the

[1] Department of Social Development (2009): *Creating our Shared Future*

introduction of National Health Insurance. This will have an impact on the provision of medical assistance and rehabilitation to the victims of accidents of road accidents and of work-related disability and illness.

A social security framework

A well-designed social security system reduces risks associated with economic change or loss of work, and contributes to household income security and social cohesion. Whether funded by the fiscus or mandatory contributions, it shares risk between the vulnerable and the not so vulnerable, offering greatest protection to those that need it most and promoting social solidarity. It also supports and complements employment objectives, labour market institutions and collective bargaining arrangements.

Social security reform fits into Government's broader development strategy. It is consistent with both the New Growth Path and the National Development Plan, as well as with Government's commitment to workers' rights.

Broadly defined, social security systems consist of three pillars:

- The first pillar comprises social assistance, which is funded by the fiscus. In 2011, grants payable to the elderly, the infirm, and to the caregivers of children provided regular income support to more than half the households in South Africa.
- The second pillar refers to mandatory social insurance arrangements that are funded by employee and employer contributions and that protect income earners and their families in the event of unemployment, disability, occupational disease, retirement or death. South Africa lacks a public pension and insurance arrangement but has established schemes that protect workers in the event of unemployment (the Unemployment Insurance Fund) or if they are victims of a disability or illness related to the workplace (the funds established under Compensation Fund for Occupational Injuries and Diseases Act and the Occupational Diseases in Mines and Works Act). The Road Accident Fund (RAF) is a statutory third party insurance arrangement for road users.
- The third pillar comprises supplementary private retirement and insurance plans. In the absence of a public social security arrangement in South Africa, many employers and unions have established compulsory funds for employees or members. However, these occupational arrangements cannot provide universal coverage and are often not cost-effective.

1.2 Key reform proposals

In reforming social security in South Africa, seven reform initiatives are proposed:

Establishment of a social security fund

The central reform proposal is the introduction of a National Social Security Fund, a centrally managed public fund to provide pensions, death and disability benefits and unemployment benefits.

All employers and employees will be obliged to contribute at a combined rate of 12 per cent of qualifying earnings up to a ceiling that will be aligned with the UIF earnings threshold (presently R149 736 per year). Government will subsidise the contributions of low-income workers to minimise disruptions to the demand or supply of labour associated with the introduction of mandatory contributions.

It is proposed that employees earning below an agreed threshold (R13 000 per year) should not be obliged to contribute to the NSSF for retirement or risk benefits but will continue to contribute to the UIF. A simplified contribution arrangement for self-employed individuals and informal workers will also be established.

The NSSF will be run on a defined-benefit basis. A worker's pension in retirement will be based on his or her career-average earnings and the duration of contributions while the disability and survivor benefit will be based on salary at the time of injury or death. The NSSF will pay a flat-rate funeral benefit.

The NSSF will provide income protection benefits for all workers and their families in combination with revised social assistance entitlements. However, those earning above the tax threshold will need to contribute to supplementary retirement savings and insurance arrangements to ensure an adequate replacement income.

Expanding social assistance

It is proposed that the means tests for social grants be phased out through alignment of social assistance with the structure of personal income tax rebates.

The objective is that all dependent children, the disabled and the elderly should be eligible for a grant, regardless of their income or assets. For families with incomes above the tax threshold, tax rebates will replace social assistance entitlements. The additional expense to the fiscus will be phased in through changes to the structure and value of tax rebates.

This reform will be accompanied by measures to improve the grants system, such as a reduction of costs associated with benefit payments. A standardised system of disability assessments across social security arrangements will improve the fairness and reduce the administrative cost of the *disability grant*.

Enhancing social insurance funds

Institutional consolidation across new and existing social security arrangements is proposed to support coherent policy-making, administrative efficiency, and effective regulation and oversight.

To bring coherence to policy, a consolidated department is proposed that will inherit the present social assistance and social security responsibilities of the Department of Social Development, the Department of Labour, the Department of Health, and the Department of Transport. Unified policy-making will ensure that the entities act in a coordinated manner to support the underlying social security framework and will facilitate the alignment of social security with the needs of the workforce and labour market institutions.

Improved coordination in administration and infrastructure across the different funds is also needed. This would reduce system costs and the potential for fraud, especially multiple claims by the same person on different funds. International experience suggests that there are considerable advantages in shared administration and payment systems across these funds, while allowing for separate regulation and supervision of specific benefits.

A number of social insurance funds are undergoing reform with the cooperation of the IDTT. In September 2011 Cabinet approved a no-fault Road Accident Benefit Scheme (RABS) to replace the RAF's existing compensation system. This change will reduce legal and administrative costs, distribute benefits to victims quicker and more fairly, and guarantee access to medical care and rehabilitation for the seriously injured.

Meanwhile, COIDA is being amended to include vocational rehabilitation and re-integration. This will promote the early return to work by the employee after an occupational injury or disease.

This paper also proposes that government employees be brought into the Unemployment Insurance Fund and COIDA.

Regulatory reform of the pensions and life insurance industry

Workers earning above the tax threshold will be encouraged to contribute to a supplementary pension and insurance plan in addition to their NSSF contributions to ensure adequate provision in the event of death or disability and an adequate income in retirement.

A default rule is proposed, under which employers will be obliged to enrol employees in a retirement fund unless an explicit choice to opt out is exercised. Preservation of retirement savings until the end of a worker's career will become compulsory, except under clearly specified circumstances.

Government will encourage contributions to approved retirement funds through the tax system. Such funds will need to meet stringent standards of care, prudence, governance, fiduciary responsibility, transparency and control of costs. Substantial improvements to the regulation of the retirement and life insurance industries are also proposed.

Strengthen the links between social security and labour

The proposed social security reforms will enhance the links between social security and employment. This should start at the level of Government, with closer policy coordination between the consolidated department of social security and the Department of Labour.

Stronger links between social security and labour also means closer institutional cooperation. Under the proposed reforms, social security agencies and labour centres will share facilities and infrastructure, thus expanding the footprint of the individual agencies and public employment services.

These closer links must also have meaning for the individual worker. Members of the labour force should have access to appropriate social security when they need it, irrespective of the nature of their employment or identity of their employers. Assistance will be provided to the unemployed to find work, and to the disabled to develop alternative occupational skills.

Improved unemployment benefits

Chronic unemployment is the main cause of workers drawing down their retirement savings before they retire. Improving unemployment benefits will reduce the need for workers to access their retirement accumulations.

The UIF has proposed changes to its existing benefit structure. It currently provides unemployment benefits for up to eight months at a replacement rate of between 38 and 60 per cent depending on a worker's salary. Credits are accrued at a rate of one day for every six worked.

Under proposed changes, credits will be accrued at a rate of one day for every four days worked and the long-term unemployed will receive a continuation benefit.

Alignment of social security with National Health Insurance

Proposals for a system of National Health Insurance were published in August 2011 and are presently undergoing a process of public consultation. These reforms, which will have implications for both public- and private-sector health services, will be phased in over a 14-year timeframe.

Four important overlaps with social security and retirement funding arrangements have to be addressed over this implementation period and have been considered by the IDTT:

(1) The role of earnings-related contributions as a financing mechanism.

(2) The tax treatment of medical scheme expenses and associated risk-pooling arrangements.

(3) The alignment of medical benefits provided by compensation funds and the RAF with the NHI system.

(4) Post-retirement access to medical scheme membership.

1.3 Comprehensive social security

The intention of these reforms is to establish a comprehensive system of social security in South Africa. They build on the work started by the Committee of Inquiry into a Comprehensive System of Social Security for South Africa (otherwise known as the Taylor Committee), which published its findings in 2002.

The proposed system will be available to all, and will protect people from loss of income caused by a wide range of events.

Social security institutions will work together in this comprehensive system. Policy-making across the different entities will be unified, their systems will be aligned, they will share infrastructure and their administrative capacity will be consolidated.

The outcome will be a significant expansion in workers' access to social security arrangements, and marked improvements in the efficiency of social security provision.

Figure 1 – A new system of social security

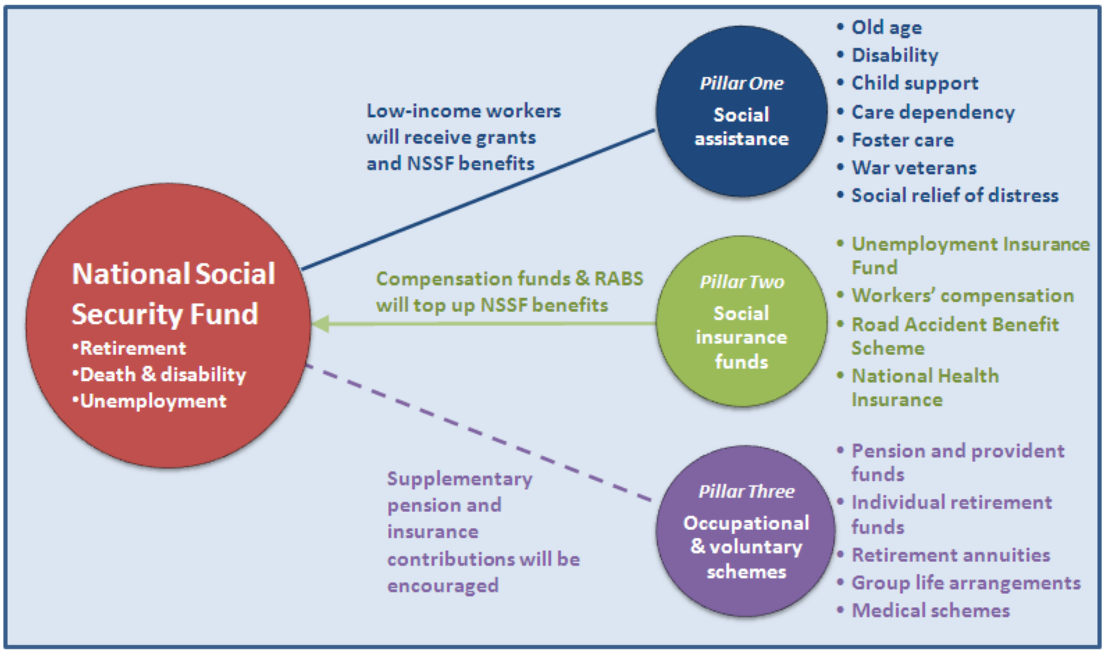


Figure 1 shows how the different social security entities will be aligned with the new fund. The NSSF will fulfil the role of a second pillar, and will subsume some of the responsibilities of existing social insurance funds. These entities will continue to perform their statutory role, but in some cases their payment and financing mechanisms will change to reflect the introduction of mandatory contributions to the NSSF.

Under the comprehensive system, non-contributory social assistance will remain a key intervention for the most vulnerable members of society. However, it will also become the foundation for the contributory system, providing an income for the elderly and the disabled that will supplement the benefits paid by the NSSF and the social insurance funds.

Voluntary and occupational schemes will allow workers to supplement their retirement and insurance contributions to the NSSF. The regulatory reform of Pillar Three arrangements that will occur as part of this reform process will ensure that these schemes are well run and provide good value for money.

1.4 Institutional arrangements, regulation and consumer protection

Eight institutional initiatives are proposed that will underpin a comprehensive system of social security. These will enhance efficiency and coherence in the implementation of social security policy, and protect contributors:

- *Collection of contributions from employers and individuals.* This will be undertaken by the South African Revenue Service (SARS), building on existing systems for pay-as-you earn and UIF collections from employers.
- *Registration of contributors and administration of accounts:* A new master registry is proposed, incorporating the UIF and South African Social Security Agency (SASSA) beneficiary registers, and maintained through contribution and payment records transmitted by employers and all social security funds.
- *Client interface:* Effective communication with contributors and claimants is central to the success of the reforms,

and will require both systems and service delivery improvements, across the existing social security entities.

- *Payment of benefits:* Modernisation and integration of payment arrangements offers considerable scope for cost-saving, bringing fragmented systems into a unified interface between SASSA accounts administration and the national payments system.
- *Investment of funds:* A blend of passive and active investment strategies is proposed for the NSSF, with private-sector fund management contracted on a competitive basis.
- *Appeals adjudication*: Alongside these arrangements, dedicated and independent capacity will be established to protect client interests, and to arbitrate and resolve disputes.
- *Regulation and oversight*: The new social security framework requires careful oversight of mandatory contributions administered by the NSSF and supplementary pensions and insurance contributions administered by approved funds. Regulatory oversight will be strengthened and approved funds subjected to a higher standard of reporting and fiduciary responsibility to protect the interests of members.
- *Public sector funds:* The new framework will require changes to public sector funds, in particular the Government Employees Pension Fund, South Africa's largest pension fund.

The recommendations in this paper will take several years to implement, and transitional measures will require careful attention. Following the consultation process, it is proposed that the reforms will be implemented over three phases:

(1) Creation of a unified policy platform.

(2) Formation of the NSSF and consolidation of social security entities, including the alignment of systems.

(3) A transition period of five to ten years for existing retirement funds to adapt to the NSSF and the approved funds framework.

1.5 The discussion paper

The IDTT has conducted an extensive review of South Africa's social security arrangements over the past four years. This paper summarises the task team's recommendations and presents them for public comment.

Section Two of this paper places social security in the context of the South African constitution and outlines the problems that exist with the present social security institutions. Section Three describes the main reform proposals to address these deficiencies, outlining the core components of the new NSSF and explaining how the existing social security landscape will change, including links to the NHI.

Section Four explains how the long-term financial sustainability of the NSSF will be maintained, discusses the impact on the existing savings and insurance industries, and outlines the institutional arrangements required to support the social security reforms, as well as the likely phasing of the reform process. Section Five concludes.

'Our unflinching commitment to human solidarity is primarily predicated on our desire to build a brighter future for all South Africans. Our efforts now are to give fresh momentum to our march in engendering human social solidarity in our social security arrangements. We will undertake a range of very fundamental social security reforms.' – Budget Speech of the Minister of Social Development, Bathabile Dlamini

2 Existing social security arrangements

2.1 Constitutional right, international standards

This section defines social security both in the South African context and according to an internationally recognised framework for workers' rights. It then describes the South African system as it is today, highlighting the deficiencies that the proposed reforms seek to address.

What is social security?

A well-structured system of social security seeks to protect every member of society, irrespective of income level or socioeconomic status, from catastrophic risk. There are two principal forms: non-contributory social assistance and contributory arrangements. Contributory arrangements are funded by participant payments, while non-contributory entitlements are funded from general tax revenue.

Non-contributory arrangements provide immediate relief from income poverty. Social assistance transfers resources from the better-off to the most vulnerable members of society and promotes social inclusion. Such arrangements are especially important under conditions of social transformation, where the process of economic development often involves the disruption of communities, with a disproportionate impact on low-income households.

Contributory social security arrangements aim to protect workers and their families through insurance arrangements against loss of income in the event of unemployment, sickness, disability or death. They also provide for life-time income-smoothing, whereby employees set aside a portion of their earnings during their working lives to provide an income in retirement.

Both forms are identified under Section 27(1)(c) of the Constitution, which states that everyone must "have the right to … social security, including, if they are unable to support themselves and their dependants, appropriate social assistance".

Although social security systems are different across every country, well-designed arrangements have the same basic features. They:

- Deepen social inclusion and cohesion
- Contribute to decent work, as part of the overall wage structure
- Complement job-creation strategies
- Encourage self-reliance
- Complement other developmental programmes
- Operate in an efficient manner to avoid wasting resources
- Are financially and institutionally sustainable over the long term.

Social security and workers

Social security is part of the "social wage", through which government services and statutory arrangements complement workers' take-home earnings. Government's responsibility for protecting workers' rights includes a commitment to making social security arrangements available to all members of the labour force.

The links between social security and labour institutions are not fully developed in South Africa. Social and labour policies should be complementary and contribute to an integrated strategy for improving livelihoods and establishing an inclusive society. As such, social security and labour policies must be developed and implemented in tandem, requiring an overarching strategy linking the two.

The International Labour Organisation (ILO) considers social security arrangements to be an important means of protecting workers' income security. This is part of the ILO's broader approach to work-related security, which also incorporates:

- *Labour-market security*: Ample opportunities for adequate income-earning activities.
- *Employment security*: Protection against unfair dismissal.
- *Work security*: Safe working conditions.
- *Skill-reproduction security:* Access to education and training that enhance workers' access to the labour market.
- *Job security*: A worker's ability to pursue a line of work that is aligned with their interests, training and skills.
- *Representation security*: Individual and collective representation to protect workers' rights.

These different aspects of work-related security are integral to the provision of decent work opportunities. However, none can be considered in isolation. There are complementarities and trade-offs between the different components, which require careful management to achieve the desired results for workers while avoiding distortions to the labour market that undermine employment creation and restrict the growth of the South African economy.

Public employment services and labour centres

Public employment services are a cornerstone of Government's strategy for promoting employment and improving the functioning of the labour market. They provide work seekers access to labour opportunities, especially through job-matching schemes, and offer them training opportunities. They also assist disabled workers, young work seekers, and workers who are facing retrenchment.

Public employment services are an important conduit to employment programmes established by Government and the private sector. These include the Expanded Public Works Programme, community projects, school-to-work programmes and vocational training. Public employment services get work-seekers or rehabilitated workers into the labour market and reduce their reliance on unemployment benefits or social assistance.

Public employment services are housed in labour centres. Labour centres also perform important social security functions: workers who have been retrenched or who have been injured at work go there to make claims to the UIF or compensation funds. They also house the inspection teams that oversee working conditions and the tribunals that protect workers from unfair dismissal.

Persistent and high levels of unemployment mean that labour centres in some parts of the country are struggling to cope with demand from work seekers.

2.2 An inclusive development strategy

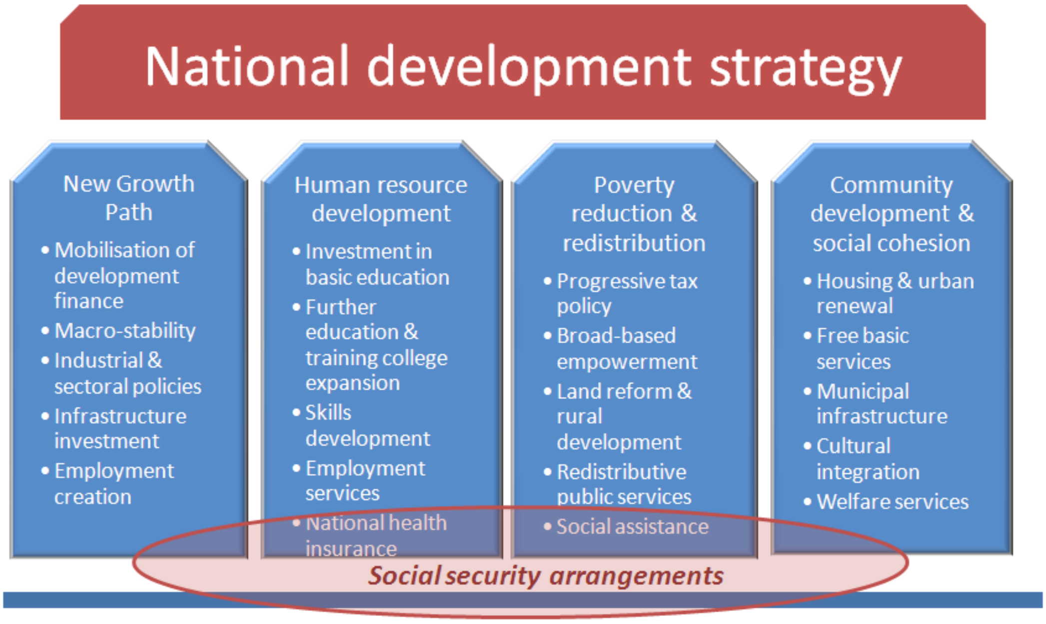
The proposed reforms to the social security system form part of Government's multi-dimensional development strategy, shown in Figure 2, which focuses on employment, reductions in poverty and inequality, and inclusive economic growth.

The New Growth Path recognises job creation as its central challenge, while acknowledging that social assistance is an important redistributive programme in the presence of high unemployment and limited opportunities for saving and risk protection.

Programmes that promote human development include education and skills development, land reform, access to housing, health care, basic services and infrastructure. No single programme is capable of achieving balanced development, and limited public resources must be allocated across a broad range of public programmes. For this reason, government needs to assess carefully the costs, benefits and linkages among public policies and development programmes.

The social security system must be affordable and financially sustainable, even under conditions of economic crisis. Modern social security systems are designed to support job creation by eliminating measures that discourage labour-market participation and establishing mechanisms that promote social integration.

Figure 2 The national development strategy



2.3 Social assistance

'The wealthiest countries in the world – as a group – have the most comprehensive systems of social protection. Social security is an essential basic service in all successful states that have experienced long-term sustainable growth rates alongside successful poverty reduction…. (W)orkers in households receiving both pensions and child support grants looked for work significantly more extensively and intensively, and found employment more successfully.' – Samson et al, 2007

Non-contributory social security

Non-contributory social assistance is Government's principal means of tackling income poverty and the first pillar of the social security system. In 2012, more than 15 million South Africans are eligible for social grants, up from 5.8 million in 2003. More than half of all households receive income from social assistance. Social grants are administered by the South African Social Security Agency (SASSA), which reports to the Minister of Social Development.

Social assistance currently accounts for nearly 3½ per cent of GDP. While this is expected to be broadly stable in aggregate, the relative share of different grants will change over time. As Figure 3 shows, the number of people aged over 60 is expected to grow from 4 million at present to nearly 8 million in 2065.

As shown in Table 1, the *child support grant* is distributed to 11 million children via their caregivers, making it the most widely accessed grant. Some 2.8 million pensioners receive the *old age grant* while the *disability grant* reaches 1.2 million beneficiaries.

The *old age grant* is the largest by expenditure, costing R33 billion in 2010/11. The *child support grant* transferred R30 billion to caregivers in poor households over that fiscal year and the *disability grant* R17 billion. Annual adjustments to the maximum values of social grants are made to compensate for inflation.

In recent years, eligibility for the *child support grant* has been raised to a child's 18th birthday while the *old age grant* was extended when the eligibility age for men was lowered from 65 to 60. The means test threshold for the *old age* and *disability* grants has also been raised.

Table 1 – Social grant recipients and expenditure: 2007/08 – 2012/13

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
Recipients (thousand)						Projected
Type of grant						
Old age	2 219	2 344	2 490	2 647	2 729	2 773
War veterans	2	2	1	1	1	1
Disability	1 413	1 372	1 299	1 233	1 265	1 192
Foster care	443	476	489	554	613	671
Care dependency	102	107	119	121	128	131
Child support	8 196	8 765	9 381	10 336	10 977	11 301
Total	**12 375**	**13 066**	**13 779**	**14 892**	**15 713**	**16 069**
Expenditure						
R million						
Old age	22 801	25 934	29 826	33 698	36 571	39 323
War veterans	22	20	17	14	12	0 013
Disability	15 280	16 474	16 567	17 030	17 813	19 152
Foster care	3 414	3 934	4 434	4 738	5 536	5 952
Care dependency	1 132	1 292	1 434	1 582	1 727	1 857
Child support	19 625	22 348	26 670	30 442	35 564	38 237
Grant-in-aid	87	90	146	160	177	188
Social relief of distress	106	623	165	143	160	165
Total	**62 467**	**70 715**	**79 260**	**87 807**	**97 560**	**104 888**
SASSA administration	4 143	4 700	5 254	5 768	6 238	6 309
Total	**66 610**	**75 415**	**84 514**	**93 575**	**103 798**	**111 197**
Percentage of GDP	*3.3%*	*3.3%*	*3.5%*	*3.4%*	*3.4%*	*3.4%*

Source: National Treasury Budget Review 2012

Studies exploring the impact of social grants have shown considerable benefits at household level, often involving redistribution between individuals in the household. The *old age grant*, for example, has been shown to raise the mobility of the working-age generation, and in households receiving the grant there is a greater propensity for children to attend school. The *child support grant* has been shown to increase labour-seeking behaviour in recipients' households.

However, income support in the event of disability and death is inadequate. The *disability grant* is complicated by difficulties in assessing and defining disability, as well as by the complexity of the means test. Survivor benefits are not available through the grants system, although the *child support* and *foster care* grants partially meet this need.

There have been significant improvements in SASSA's administration of grants, especially by making payments through the banking system. However, in remote areas lacking basic infrastructure, cash payment mechanisms remain the norm, though these involve high operating costs which must be met by the fiscus.

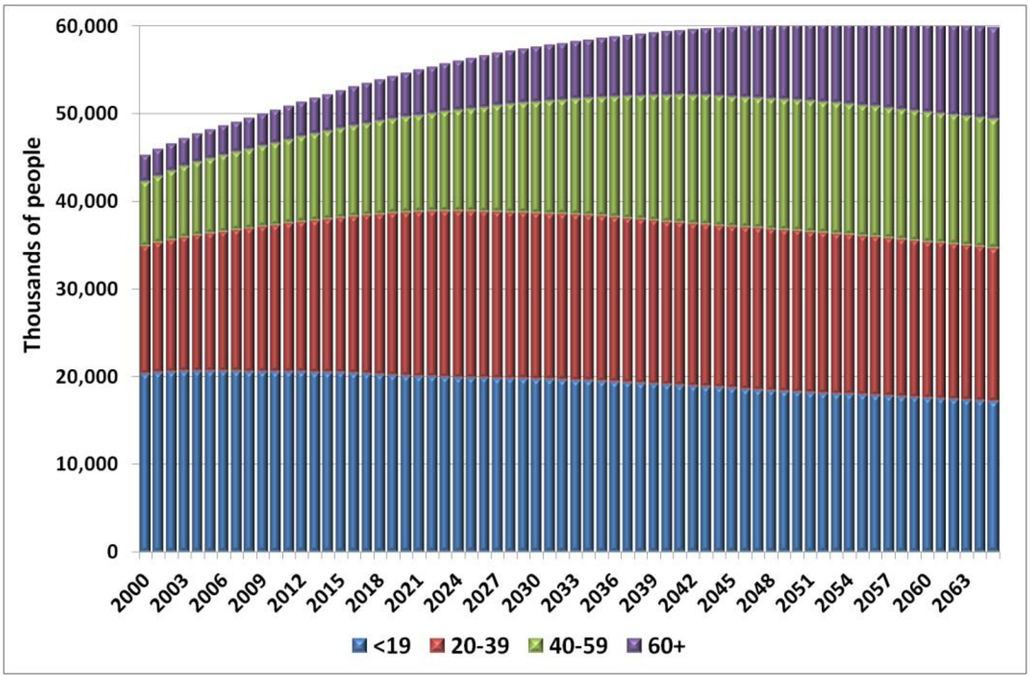
Means tests and conditional grants

The means tests that determine eligibility to social assistance are intended to ensure that grants are targeted at the most vulnerable members of society. However, they discourage saving and asset accumulation and so contribute to a "poverty trap", even among low-income workers with stable incomes. They can also exclude people who are in need of the grants.

The alignment of social grants with the personal income tax rebate structure will allow the means tests to be phased out and remove this bias against household saving and asset accumulation. This will benefit low-income households and reduce administrative complexity.

Some countries have adapted their income support arrangements to address complementary objectives, such as training or work-seeker support, or education and health care of children. While conditional or incentive-linked grants may contribute to targeted social outcomes, these arrangements are difficult and costly to administer and there may be unintended negative effects on income security.

Figure 3 Projection of the population of South Africa over the age of 45



Source: Actuarial Society of South Africa

South Africa's social assistance law recognises social grants as entitlements, though there are associated responsibilities of caregivers in respect of the *child support* and *care dependency* grants. Strengthening of welfare and social development services will in time contribute to improved links between social assistance and specific household needs and circumstances.

Target groups

Children in poverty and their caregivers account for more than 50 per cent of people in poverty. They will continue to be the focus of measures to enhance social assistance. Childhood poverty will also be reduced by the provision of survivor benefits by the NSSF, whereby children of a deceased worker will receive an income stream until they complete their education.

Unemployed adults aged between 18 and 59 account for about one quarter of those living in poverty, or some 4 million people. Employment creation, training and improved access to new job opportunities are the most important vehicles for support to this target group.

2.4 Social insurance funds

South Africa lacks a statutory pension and insurance arrangement. However, it has a set of social insurance funds that provide benefits under specific circumstances:

- The UIF provides short-term unemployment insurance to qualifying workers;
- The RAF provides compensation for losses incurred due to injuries caused by the wrongful or negligent driving of another vehicle; and
- The funds established under the Compensation Fund for Occupational Injuries and Diseases Act (COIDA) and the Occupational Diseases in Mines and Works Act (ODMWA) pay medical care and income benefits to workers who suffer a disability or illness related to their employment.

Unemployment Insurance

The UIF provides short-term unemployment insurance to qualifying workers. At present, it does not cover the whole workforce, as employees of national and provincial government are excluded.

The UIF pays benefits to contributors or their dependants in cases of unemployment, illness, maternity, adoption of a child or death. It is funded by contributions equivalent to two per cent of a worker's wages, half of which is met by the employer and half by the employee. Contributions to the UIF are subject to a cap, which is calculated to be consistent with the salary paid to a skilled manual labourer. This cap is presently set at R149 736.

At present, workers earn credits for every day they work based on a four-year cycle; the maximum credit a worker can accrue is eight months. However, the UIF has proposed extensions to the period over which credits can be accrued and benefits received, outlined in Section Three.

Workers who are retrenched can claim a benefit from the UIF based on their income at the time of retrenchment. These benefits decrease gradually in relative terms with income; the fund pays a benefit worth 60 per cent of the lowest-income worker's income and 38 per cent to those earning at or just below the ceiling.

The unemployment benefit is one of a number of measures intended to facilitate an unemployed worker's transition to a new job. The UIF also provides work seekers with access to training schemes and other Active Labour Market Policies. In 2009 it co-sponsored the training lay-off scheme by providing R1.2 billion to the programme, which sought to alleviate the impact of the recent recession on employers in distress.

Compensation funds

The compensation funds provide medical care and income benefits to workers injured on the job or who develop occupationally-related diseases. They also provide survivor benefits to families of victims of job-related fatalities and funding for vocational rehabilitation of disabled workers.

Costs are recovered through levies on employers, at rates that depend on a firm's risk profile and accident record. This arrangement encourages employers to improve workplace safety.

Three principles underpin the design of the compensation funds and must be safeguarded under the new social security landscape:

- *Work-relatedness*: The accident or disease was caused by the worker's job.
- *No fault*: Employees who receive benefits from the Compensation Fund lose their right to sue their employer, and the employer cannot assign fault to the employee.
- *The prevention of occupational accidents and diseases*. The risk-based levy encourages employers to improve health and safety standards. Inspection teams monitor employment conditions.

The largest of the funds is the Compensation Fund, which is administered by the Department of Labour and serves private sector employees. The Department also administers compensation claims of government employees, which are financed by appropriation and not through the Compensation Fund. The Compensation Commissioner for Occupational Diseases (CCOD), in the Department of Health, provides compensation to miners and former miners who have contracted lung-related diseases.

Employers operating under COIDA have a choice of registration either with the Compensation Fund or two independently managed arrangements – the Rand Mutual Association and the Federated Employers' Mutual Assurance – which compensate injured workers from the mining and building industries respectively. These funds are monitored by the Department of Labour and operate under licenses granted by the Minister of Labour.

The benefits offered under COIDA and ODMWA are poorly aligned. The benefits available under COIDA are higher and take the form of an income stream (unless awards are relatively small), whereas ODMWA only pays lump-sum benefits which can be quickly exhausted. Government employees who are injured on duty are compensated by the Government Employees Pension Agency, after assessment by the Department of Labour.

The fragmentation, administrative shortcomings and gaps in coverage of the present compensation arrangements should be addressed through a consolidation and modernisation of the occupational injury and disease funds, founded on a unified occupational health and safety law. This will also address uneven benefits between the entities.

Table 2 Social security funds, 2008/09 – 2014/15

R million	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
		Outcome		Revised estimate		Medium-term estimates	
Unemployment Insurance Fund							
Revenue	13 691	14 199	14 865	15 769	17 028	18 120	19 196
Expenditure	4 636	6 581	6 435	8 159	9 166	10 040	11 029
Compensation Funds							
Revenue	6 860	7 334	6 950	7 224	7 785	8 374	9 025
Expenditure	3 451	3 893	4 065	3 175	3 470	3 612	3 764
Road Accident Fund							
Revenue	11 865	11 785	14 293	15 733	17 662	19 695	21 798
Expenditure	11 966	12 221	13 810	13 883	16 748	18 991	21 026
Total: Social security funds							
Tax revenue	23 288	26 956	29 602	32 104	35 180	38 310	41 599
Non-tax revenue	6 619	6 353	6 494	6 583	7 279	7 860	8 399
Grants received	2 509	0 010	0 012	0 039	0 017	0 019	0 020
Total revenue	**32 416**	**33 319**	**36 108**	**38 726**	**42 475**	**46 189**	**50 019**
Total expenditure	**20 054**	**22 695**	**24 311**	**25 216**	**29 385**	**32 643**	**35 818**
Budget balance[1]	**12 362**	**10 624**	**11 797**	**13 510**	**13 091**	**13 546**	**14 201**

1. A positive number reflects a surplus and a negative number a deficit

Road Accident Fund

The RAF is a mandatory third-party insurance arrangement financed by a dedicated fuel levy. It provides compensation for loss of earnings, along with general damages, medical and funeral costs, to victims of road accidents caused by the negligent or wrongful driving of another vehicle. Beneficiaries forgo the right to sue the person found to be responsible for the accident.

In September 2011, Cabinet approved the Road Accident Benefit Scheme (RABS). It will provide for a more equitable, affordable and sustainable system of benefits that conforms to the right to social security and health care established in the Constitution. The new system, which will operate on a *no fault* basis, will reduce expenditure on claims settlement and legal costs while improving reimbursement of medical expenses.

Whether they were responsible for the accident or not, victims will receive an income and medical benefits in a timely fashion, and will be guaranteed access to appropriate health care, rehabilitation and lifelong care where this is necessary.

Institutional fragmentation

The existing social security arrangements are highly fragmented. They are established by different legislation, and are overseen by different Government departments.

The UIF and COIDA are overseen by the Department of Labour, while the Department of Transport is responsible for the RAF and the Department of Health for the CCOD established by ODMWA.

The fragmentation between these entities has four main consequences:

(1) *Uncoordinated policy-making*: In the absence of an overarching institution responsible for social security, the entities develop policies that are aligned to their own mandate without considering the activities of other social security agencies.

(2) *Lack of benefit alignment*: The benefits offered by the funds are poorly aligned. They each have their own benefit levels, eligibility rules, and assessment criteria. This is especially unfair in the compensation environment, where beneficiaries under COIDA receive higher benefits than those provided by ODMWA.

(3) *Fragmented administration*: There has also been no attempt to rationalise the common

processes and administrative functions that exist across the social insurance entities and SASSA such as contribution collection, case management and benefit payment. This has led to unnecessarily high administrative costs associated with the provision of social security, and a system that is vulnerable to fraud.

(4) *Financial discrepancies*: There are major discrepancies in terms of each entity's financial wellbeing. Table 2 shows the revenue and expenditure flows of the main social insurance funds as they are reflected in the national accounts but it does not reflect their balance sheets. A consolidation of the social insurance funds will result in greater transparency and efficiency.

2.5 Social security and National Health Insurance

Social insurance and improving health outcomes

Mindful of initiatives currently in progress to reform health financing arrangements in South Africa, the IDTT has reviewed the links between social security reform and the implementation of National Health Insurance.

An important point of departure is the recognition that South Africa lags behind many other countries in meeting health-related Millennium Development Goals – reducing child mortality, improving maternal health and combating HIV/Aids, malaria and other infectious diseases. Many peer group countries (with similar levels of income per capita) provide an affordable "core health package" that yields better health outcomes than South Africa achieves.

The reasons behind poor performance on health indicators are not always related to health service delivery. There are several inter-related priorities to consider as part of a strategy aimed at achieving better health outcomes – for example:

- Improved water supply and sanitation
- Vector control aimed at combating malaria
- Improved environmental health, nutrition and residential living standards, together with treatment and control of TB and infectious diseases
- HIV prevention and Aids treatment
- Vaccination against childhood diseases
- Trauma services and road accident prevention.

Broadening access to health services therefore needs to be balanced with funding for other health promotion and development investments. The health system reforms that are included in the NHI are to be based on principles that contribute positively to social and financial risk protection. These include:

- Universal coverage of a comprehensive package of health services
- Social solidarity
- Services largely free of charge at the point of use
- Mandatory, payroll-linked contributions.

Public and private health financing

The gap between public health spending and comprehensive health care coverage is large and reflects the broader inequality of income and wealth that characterizes the South African economy.

The divergence between public and private sector resources, staffing and patient-loads of hospitals and health facilities is considerable, and the governance and management reforms required are at least as demanding as the financing issues. Extensive legislative and regulatory reforms will be required for broadening access to health insurance through standardized provision of a comprehensive package of health services to all citizens.

Better alignment between public and private hospital services and shared financing arrangements depend on common information systems and considerably improved management systems in the public health system.

In August 2011, the Department of Health initiated public consultations on the policy. Preliminary discussions suggest that the NHI is to be funded via general taxes and an earmarked mandatory contribution, which would then form part of the broader social security financing framework.

The role of medical schemes as NHI intermediaries and in offering supplementary health insurance, risk equalisation between medical schemes, the level of employer-employee contributions, the fiscal contribution to health insurance, the administrative structure and the role that the private sector will play in service delivery and provision under an NHI system are amongst the issues on which further analysis and consultation will be needed.

NHI and social insurance funds

Once NHI is fully implemented, its coverage will include medical benefits currently reimbursed by the social insurance funds. It is therefore necessary for the compensation funds and the Road Accident Fund to prepare for their integration into the National Health Insurance over the period ahead.

Aligning the health insurance arrangements of the compensation funds and the Road Accident Fund will be an important step in this journey. Although there are broad similarities between the injury assessment, treatment and rehabilitation needs of occupational and road accident victims, the IDTT's research has found that these systems are inconsistent and administratively inefficient.

There is also a need to address transition issues in the post-retirement health insurance landscape. Currently, many employers carry medical scheme contribution liabilities for former employees and many employees are uncertain about whether they will be able to afford medical scheme membership after retirement. For medical schemes facing rising numbers of elderly beneficiaries, it is necessary to implement a risk equalisation arrangement if funds are to remain solvent and fairly priced.

2.6 Occupational and private retirement funding

In the absence of a statutory pension and insurance fund, companies and trade unions have established retirement-savings and insurance arrangements for their employees or members, often as a condition of employment. Income-earners can also enrol in individual retirement schemes, such as Retirement Annuities.

In total, some 5 million South Africans belong to private arrangements, a relatively high proportion of the workforce by international standards though far short of universal coverage. Coverage varies according to a worker's income, the sector of employment and the degree of unionisation in that sector.

Many bargaining councils, established under the Labour Relations Act, provide savings and insurance arrangements for workers covered by their collective agreements. There are 40 private sector bargaining councils, of which 29 councils offer one or more funds to their members. More than one million workers are covered by such arrangements.

These tend to be provident funds rather than pension funds. Some of these are directly administered by bargaining councils or trade unions, but more commonly professional fund administrators are employed.

Government employees are entitled to retirement and death or disability benefits governed by the rules of the Government Employees Pension Fund (GEPF), which is the largest pension fund in the country.

Whereas the GEPF and several other public sector pension funds pay a final-salary defined-benefit pension, most private sector arrangements are now defined-contribution schemes, in which accumulated savings determine the value of benefits at retirement.

Table 3 Occupational pension scheme coverage by income

Annualised income	Percentage of workers with income in range	Employer contribution to pension/retirement
R0-R6 000	7.9%	6.2%
R6 001– R12 000	16.9%	14.0%
R12 001– R18 000	13.1%	28.2%
R18 001– R30 000	16.3%	48.2%
R30 001– R42 000	9.8%	73.8%
R42 001– R54 000	7.0%	79.6%
R54 001– R72 000	6.5%	83.0%
R72 001– R96 000	5.4%	89.1%
R96 001– R132 000	4.9%	89.2%
R132 001– R192 000	3.1%	89.4%
R192 001+	2.9%	85.3%
Total	**100.0%**	**51.1%**

Source: Labour Force Survey 2006

There are two principal shortcomings in occupational retirement schemes, related to the quantity and quality of coverage:

- As Table 3 shows, lower income workers are often excluded from such funds, meaning they are inadequately protected against death, disability or substantial reduction in their income at retirement. They rely on social assistance, as is the case with South Africa's informal workforce.
- In some instances, high administration and asset management costs erode the value of workers' contributions. Workers often have less money in their fund at retirement than they reasonably expected.

Despite these failings, there are considerable strengths in both the private and public sector savings and life insurance industries, and in the country's liquid capital market and competitive financial services industry.

These include well established benefit administration and fund management systems. The insurance sector is categorised by low margins and competitive pricing (where insurance is obtained on a group basis rather than on individual terms).

An adequate and lasting retirement income

The value of a pension is commonly expressed as a "replacement rate", relative to a worker's career earnings. The ILO advises that a 40 per cent replacement rate is a reasonable minimum, and that a retirement system can therefore be considered adequate if a worker with a full career (at least 30 years in formal employment) receives an income in retirement of at least that level.

In the existing social security landscape, a substantial proportion of workers do not receive a decent income in retirement. Research by the Department of Social Development indicates that average replacement rates are in the region of 24 per cent – far short of the 40 per cent benchmark. This means that the majority of workers suffer a substantial decline in living standards during their retirement years.

The primary cause of low replacement rates is early withdrawals from retirement funds during a worker's career. Many workers liquidate their funds each time they change jobs. When people face a life crisis, or have spent a long time out of work, they may have no other option. Nonetheless, workers should be encouraged to preserve their retirement savings for as long as possible.

Low levels of preservation are not the only reason why workers' retirement incomes are too low. The high costs associated with certain retirement products, imprudent investments and poor governance and administration reduce the value of a worker's lifetime savings. This problem is exacerbated by limited financial literacy in the workforce – a well-documented feature of all societies.

Another concern is that few members of provident funds annuitise their retirement accumulations. Annuities provide a guaranteed monthly income until death, meaning a pensioner can never outlive their savings. However, the South African annuity market provides poor value for money to retirees with low life expectancy, who tend to be lower-income earners. The up-front fees associated with the purchase of an annuity can also substantially reduce the value of the monthly income.

The reform challenge

Problems with private arrangements have led many countries to introduce statutory pension funds. However, international experience indicates that public social security arrangements cannot provide full income protection for every worker: it is also important to encourage supplementary occupational and voluntary pensions and insurance contributions as the third pillar of a social security system for those who can afford to make such contributions.

The reform challenge is to find an optimal mix of statutory, pooled and standardised social security mechanisms, alongside supplementary voluntary and occupational arrangements. Regulatory and governance reforms of the private savings and insurance industries are outlined in Section Three, to improve efficiency and customer protection and to reduce costs in private schemes.

3 An integrated system of social security

3.1 A mandatory pension and insurance system

The absence of a statutory arrangement providing pensions and insurance is the most obvious gap in South Africa's social security system. Such an arrangement must be mandatory, should provide adequate but affordable benefits, and should pool risk across the workforce. It should be designed to interact with non-contributory social assistance as well as contributory arrangements, both statutory and voluntary.

The design of a new social security system must recognise the varying needs of different groups. Those who live long beyond their salary-earning years need an adequate income in retirement, but those who die young require assurance that their dependants will be provided for. Those who suffer accidental injuries and lose their capacity to work need a replacement income (and in some cases compensation), while those who lose their jobs through the vagaries of economic and industrial trends need to be assisted in finding alternative work and meeting interim income needs.

The number of people who receive these different benefits will change over time. As life expectancy improves, the relative share of social security expenditure that finances retirement will rise relative to other benefits. The design of the proposed social security system is based on the analysis and management of long-term demographic trends and their implications for social needs.

Consistent with the requirements of the Constitution, it is envisaged that an integrated social security system for South Africa should cover all citizens and permanent residents, including migrant workers. All workers, with earnings above a minimum threshold, should contribute to the pensions and insurance arrangement under consideration.

However, it is not reasonable to expect the lowest-paid workers to make full contributions to the new fund, and it would be counterproductive to raise the costs of employment beyond the reach of more labour-intensive industries and enterprises.

It is therefore proposed that Government should meet part of the contribution costs of lower-income employees. Otherwise, such workers might move into the informal sector to avoid contributing to the fund, which would leave them unprotected and put the system's sustainability at risk. This is one of the ways in which the social security funding arrangements will serve an important redistributive function within the broader, and unusually unequal, income structure of the South African economy.

The design of the new arrangement will be based on the following principles and objectives:

- *Enhance coverage of retirement savings and insurance arrangements.* At present, social insurance coverage of low-income earners and certain sectors is inadequate. The NSSF will enrol workers across all sectors of the economy.
- *Allow workers to smooth incomes over their lifetime and enjoy risk protection through cost-effective arrangements.* All workers earning above a minimum threshold will be mandated to participate in the NSSF. As earnings rise, workers will be encouraged to make supplementary contributions to regulated and approved funds.

- *Preserve and improve the best attributes of the existing private pension system.* An approved fund framework will ensure that well run, fully transparent funds will receive tax-incentivized supplementary retirement and insurance contributions.
- *Encourage job creation and formal employment.* Social security arrangements must support labour activation programmes and positively reward formalisation and regulation of work arrangements.
- *Encourage retirement savings and efficient allocation of capital*. The NSSF and the approved fund framework will promote preservation of retirement savings and enhance regulation of fund management within a competitive environment.
- *Manage and share risk appropriately.* The NSSF will assure a basic level of income protection, with risk carried across society as a whole, underwritten by government. Supplementary contributions allow participants to manage risks privately while seeking market-based investment returns in a suitably regulated environment.

3.2 The National Social Security Fund

Government proposes an integrated social insurance scheme, the National Social Security Fund (NSSF). The NSSF will fill a significant gap in South Africa's social security arrangements, and it will complement social assistance programmes, social insurance funds and private arrangements.

The NSSF will provide pensions to workers who reach retirement, disability benefits to those who are physically unable to work and survivor benefits to their dependants should they not live until retirement. Contributions to the pension and risk benefit components of the NSSF will be pooled, sharing risk across all contributors.

A social security payroll contribution worth 12 per cent of earnings is proposed, to be met by employees and employers. This includes unemployment insurance, which will continue to be paid at the rate of two per cent. There will be both a floor and a ceiling to contributions: it is proposed that workers earning less than R13 000 per year should not be obliged to contribute to the NSSF, though they will continue to contribute to the UIF. Those earning in excess of the UIF ceiling (presently R149 736) will not contribute on income above that level.

Pensions

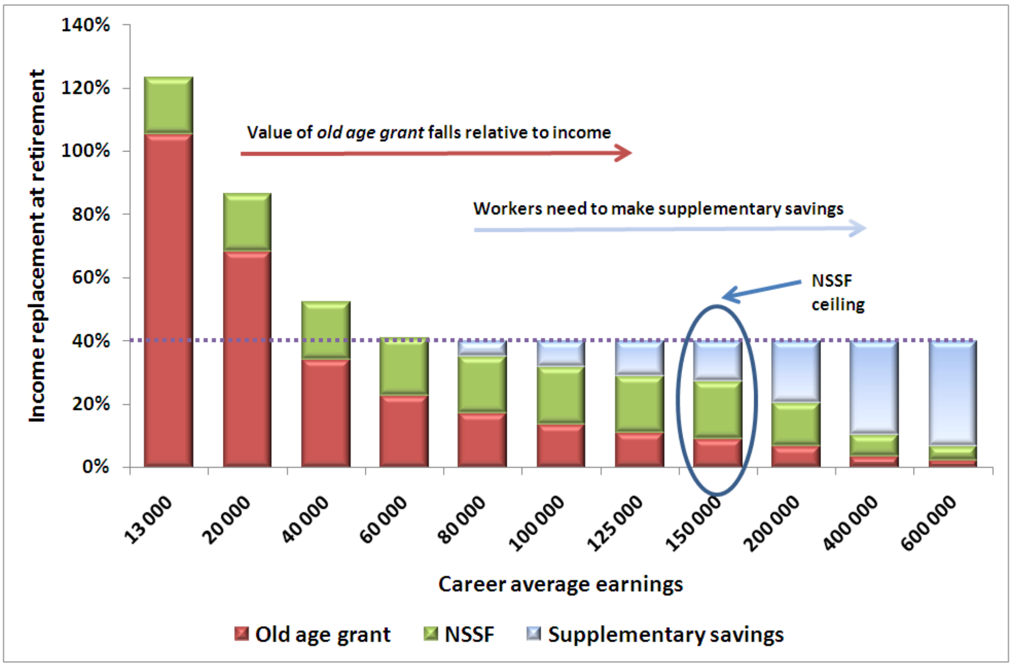
At retirement, a worker who contributed to the NSSF will receive a pension calculated according to a straightforward formula based on lifetime wages, length of service, and an accrual rate to determine what proportion of average earnings (up to the contribution ceiling) the worker would receive for every year worked.

This is a defined-benefit pension plan, though its design is intended to yield an income in retirement similar to the average expected outcome of defined-contribution plans. The defined-benefit design means that workers with equivalent contribution records will receive the same pension, as investment risk is carried by the system as a whole. A worker's pension should represent a fair return on contributions during his or her career, taking into account that risk benefits are also a claim on these contributions.

The NSSF has been designed to enable workers who have worked a full career to achieve an income in retirement of at least 40 per cent of their earnings over the course of their career. However, workers will not achieve this replacement income through the NSSF alone: for lower-income workers, the old-age grant will continue to contribute to income in retirement, while higher-income earners will need to make supplementary contributions during their careers if they are to achieve an adequate retirement pension.

Figure 4 shows how the composition of workers' retirement income will change according to their career-average earnings (assuming that the old age grant is available to all). The system is designed to provide a worker with 30 years of contributions to the NSSF, and average career earnings of R75 000 a year, with a replacement income of R30 000 (40 per cent) in retirement without contributing to a supplementary scheme. If such workers wish to receive a higher replacement rate, they will need to contribute to an approved supplementary fund.

Figure 4 Composition of retirement income at different income levels against a 40 per cent target



Disability and survivor benefits

Workers who are unable to work until retirement age will qualify for benefits to meet basic income needs. If a worker becomes permanently disabled, he or she will receive an income based on their salary at the time the accident occurred.

Income support will also be paid to a worker's dependants if he or she dies before retirement. The NSSF would pay a survivor benefit based not only on the worker's salary but also the number of dependants that the worker leaves behind.

The benefit will be paid out for each child until they reach age 18 or complete their education, so the younger a deceased worker's children, the longer the benefit would last. Surviving spouses would receive a benefit for a limited period of time, to assist the household's adjustment to the loss of earnings.

Importantly, the amount that a worker receives through risk benefits will not be determined by the length of time that they made contributions. A worker who has been contributing to the NSSF for one year would be entitled to the same risk benefits as one contributing for 15 years, provided they earned the same salary and had the same number of dependants.

The worker who has only worked for one year would thus receive risk benefits from the NSSF far in excess of his or her contributions. This is achieved by pooling contributions across the entire workforce: the NSSF covers the difference between this worker's entitlement and contributions with the contributions of other members.

In this way, it is not only contributions that are pooled, but also risk: the needs of those affected by risk events are in part covered by those who do not suffer injury or die prior to retirement. Because disability and mortality risks decline as income rises, the NSSF redistributes to lower-income earners in these arrangements.

Recipients of the disability benefit will be eligible for a pension if they reach retirement age. The benefit calculation will treat the years they received the benefit as years of service and base the career-average salary on their wages prior to suffering the disability (adjusted for wage inflation). Recipients of the disability benefit who do not reach retirement will be eligible for survivor benefits based on their last salary before becoming disabled.

Risk benefits will usually be paid as a monthly income stream rather than as a lump sum. Lump sums will only be appropriate if the awards are relatively small.

Expanding UIF benefits

The following changes to the Unemployment Insurance law have been proposed under the Unemployment Insurance Amendment Bill, 2011:

- The fund may be used to finance re-entry of unemployment insurance beneficiaries and contributors to the labour market.
- A contributor's entitlement to benefits will accrue at a rate of one day's benefit for every completed four days of employment subject to a maximum accrual of 365 days benefit in the four-year period. Previously, workers accrued benefits at a rate of one for every six days worked, up to a maximum of 238 days.
- A contributor is entitled to illness benefits if the period of illness is longer than seven days, versus 14 days previously.
- The first 238 days of benefits will be paid at a replacement rate of between 38 per cent and 60 per cent of a worker's income, depending on the contributor's earnings level. Thereafter, benefits will be paid at a rate of 20 per cent for a maximum of an additional four months.

Unemployment insurance

Unemployment insurance will continue to be credit-based but these credits will be accrued at a faster rate (as described in the box above). The UIF has also proposed an extension of the benefit for unemployed workers who remain out of work after the exhaustion of their 238 credit days. This will be worth 20 per cent of their income and will last for a maximum of four months. It will be subject to conditions associated with government's labour activation and employment service reforms.

This additional benefit for workers who have exhausted their credits acknowledges the needs of the long-term unemployed. It also reflects Government's commitment to reducing the need for workers to access their accumulated retirement savings.

It is recognised that the continuation benefit outlined above will not meet the longer term income needs of the chronically unemployed or older workers who have lost their jobs and are unlikely to be re-employed. Options for funding a more extended continuation benefit are being explored. This would be limited to a fixed rand amount.

Funeral benefit

The NSSF will offer a flat-rate funeral benefit to all its members. This will replace the funeral benefits to which members might have been eligible from the social insurance funds.

Contribution subsidy

The IDTT is mindful that a ten per cent payroll contribution for retirement and risk benefits would be a significant burden for low-income workers, and an additional cost to employers. The NSSF needs to be structured and financed so that it does not serve as a disincentive either to job creation or to participation in the formal labour force.

A contribution subsidy is therefore proposed, with government paying all or a portion of the NSSF contribution for low-income employees. This subsidy

The NSSF contribution ceiling

The contribution ceiling is a key feature of a social security fund. Although all workers should be included in the system to share risk across the whole workforce, it is not desirable to protect incomes above a certain level. A social security system should provide greater protection to low-income workers, while providing scope for higher income earners to augment their retirement savings through alternative vehicles that offer greater diversity of benefits without imposing risk on the fiscus. The contribution ceiling therefore allows middle and higher income earners to contribute to occupational or voluntary retirement and insurance funds while also participating in the statutory social security arrangement.

will be paid from the fiscus. Its design will encourage formalisation of employment, and contribute more broadly to protecting decent terms and conditions of work.

3.3 Interaction of the NSSF with social security and labour arrangements

The NSSF will seek to complement existing retirement and insurance arrangements rather than replace them. For lower-income workers, social grants will continue to play an important role in providing benefits for retirees, the disabled and children. The social insurance funds will continue to address specific events as per their legislative mandate. Workers earning above the personal income tax threshold will be encouraged to make supplementary contributions to well-run private-sector pension and insurance arrangements.

Social assistance

The social assistance system will continue to provide a safety net for the poorest households. However, social grants will no longer work in isolation but will be administered alongside the NSSF. Social assistance will serve as the foundation of an integrated social security system rather than as a last resort for those on the margins of the productive economy, and it will be linked to labour-market instruments and initiatives.

The key change to the social assistance system will be the gradual elimination of the means tests for *child support* and the *old age* and *disability grants*. The thresholds for the means tests will be raised over time until they are aligned with personal income tax rebates of equivalent value.

The result will be that workers will no longer forgo social grant entitlements if they earn improved wages or retirement pensions. The *old age grant* will provide part of all workers' retirement income, either as a cash transfer or as a tax rebate. The NSSF disability benefit will be added to the *disability grant*. However, the grants will remain at a flat rate, so will represent a declining proportion of income at higher salary levels.

This interaction between social assistance and the NSSF will require commonality between the disability assessments for both systems.

A more complex issue is the eligibility age for retirement benefits. While the eligibility age for the *old age grant* is now 60 for both men and women, a later retirement age is likely to be required for a full pension from the NSSF. The current personal income tax schedules provide for a secondary rebate at the age of 65. As life expectancy rises, the retirement age associated with defined pension benefits will need to be raised.

Over time, further adaptations to the social security system may come under consideration to respond more effectively to the needs of identified vulnerable groups. Alongside measures to increase job creation and improve access to training and employment opportunities for adult work seekers, options for extending unemployment insurance are being explored. Links between social security and employment services are central to labour market activation as part of a more dynamic growing economy.

Recognising the need to support workers in lower-paid sectors and occupations, a social security contribution subsidy will be funded as part of the overall social protection budget.

Social insurance funds

It is proposed that the UIF, the compensation funds and RAF/RABS will continue to provide insurance for workers and their families against loss of income arising from specific circumstances. Coverage of UIF and COIDA will be expanded to the entire workforce by incorporating government employees.

The compensation funds and RAF/RABS will remain responsible for victims' trauma care and rehabilitation. However, the arrangements for financing income and medical benefits will adapt, over time, to the phasing in of the NSSF and NHI respectively.

Contributions

Contributions to unemployment insurance will be included in the overall 12 per cent NSSF contribution, and unemployment benefits will be paid out from the NSSF. However, contributions to the UIF will not be pooled with the pension and risk contributions, and its funding arrangement will remain as it is at present.

The compensation funds will continue to rely on a separate revenue stream alongside the NSSF, funded by levies on employers. The RABS will also operate as a separate funding arrangement and be funded by a fuel levy.

Benefits

It is proposed that the NSSF should provide part of the income-related benefits that are currently paid by the compensation funds or are envisaged under RABS, to the extent that these form part of the standard disability and survivor benefits to which the worker is eligible under the rules of the NSSF.

The victim of a workplace injury will be entitled to benefits both from the NSSF and from the Compensation Fund. In these circumstances, they will receive their full benefits as per the rules of the Compensation Fund, the income-replacement aspect of which will always be higher than the NSSF. However, the Compensation Fund will not meet the entire cost of the income benefit: the NSSF will pay the entitlement under the NSSF rules and the Compensation Fund will make up the difference.

A similar calculation will be made for a road-accident victim who has contributed to the NSSF. Where a road accident victim is not covered by the NSSF, RABS will be responsible for paying his or her benefits.

It is appropriate for the compensation funds and RABS to structure their benefits in the same way, even though the level of benefits might differ according to whether the accident was work-related or occurred on the road. Where a road accident was work-related, the victim should receive the Compensation Fund income benefits, which will be higher than the entitlement under RABS for the same degree of impairment.

It is also necessary that a standard disability measure and assessment process should be established across the social security landscape (see box below).

These arrangements between the NSSF and the compensation funds and RABS will have implications for the financing of the different funds which will require careful investigation.

In future, the compensation funds and RABS will focus more strongly on the hospital treatment and vocational rehabilitation costs associated with recovery from an accident. There is considerable scope for them to adopt common mechanisms for classifying cases and reimbursing hospitals and service providers.

Improvements in these arrangements will serve as stepping-stones towards a unified system of health financing. At a later stage it will be determined to

A common disability measure

At present, disability is assessed differently across different social security entities. In the new social security landscape, assessments of disability will be harmonised in order to achieve transparency and consistency.

Disability assessments for the *disability grant* determine whether an applicant has a disability without specifying the degree of the impairment. The assessment procedure is applied differently across the country and it is often the case that the medical resources are not available for a thorough examination.

Under the *Compensation Fund* rules, workers with disabilities are assessed according to the American Medical Association disability framework, which quantifies the degree of a worker's impairment. The level of benefit is determined by this degree of impairment: the higher the degree of impairment, the less able a worker is to return to work and the higher the benefit that he or she receives.

The proposed *Road Accident Benefit Scheme* will provide income replacement benefits on a similar basis to the Compensation Fund, with the benefit dependent on the injured worker's capacity to earn. However, it has not yet been decided what assessment tool will be used.

Given that the disability benefits paid by the *NSSF* will almost certainly operate on a similar basis, it is necessary that a single disability assessment metric be established for all social security entities, including SASSA. This assessment tool be applied evenly across the country, which might require a dedicated capacity for the performance of disability assessments.

what extent NHI meets these funds' medical expenses rather than the funds themselves.

Consolidation of policy and administration

Specific funding streams are retained in the consolidated social security landscape because they address specific risks relating to the workplace and the roads. As such, they require specific capacity, expertise and infrastructure.

However, the IDTT has identified considerable scope for enhancing coordination across these entities through unified policy-making, common benefit structures and consolidation of administrative systems and platforms. This process will require legislative harmonisation; work is under way to assess how far this is possible.

- *Unified policymaking*: The establishment of a single department responsible for social security will ensure that different entities adhere to an overarching set of social security policies and to Government's broader objectives.
- *Benefit alignment*: Under the proposed framework, individual entities will provide different *levels* of income-related benefits. However, it is desirable to establish a common *structure* of benefits. This will normalise aspects such as the definition of dependant and minimum benefit levels.
- *Fragmented administration*: The establishment of common systems for contribution collection, case management and payments will significantly enhance the administrative efficiency of social security, achieve considerable savings and improve service delivery.

Establishing a common interface for social security claimants will be a key aspect of this administrative consolidation. This will require the different social insurance entities, including the NSSF and SASSA, to share branches and call-centre facilities. Table 4 indicates the current footprint of RAF, SASSA, and the UIF's labour centres. The RAF is planning to increase its presence in the near future.

Linking with labour

The consolidated department of social security will ensure that social security policies complement labour initiatives and adhere to the country's development path, as described in Section Two. Mandatory participation in the NSSF will complement labour market reforms currently under consideration which are aimed at improving the protection of workers in temporary or atypical employment.

A key interaction between labour and social security will be the sharing of facilities between social security entities and labour centres. Shared offices will provide a key point of contact between social security recipients and labour-market initiatives. They will also greatly expand the footprint of public employment services, which currently lack the capacity to deal with the large numbers of job-seekers in the labour market.

In the new environment, the links that presently exist between social security and labour institutions will be reinforced. The UIF serves as an important vehicle for assisting unemployed persons to access employment services and training opportunities. The compensation funds have responsibilities for rehabilitation and assisting in identifying suitable work opportunities for those who have suffered injuries in the workplace.

Inspection teams, which are funded through the Department of Labour, will continue to play an important role in overseeing labour conditions and strengthening the relationship between Government and individual employers.

Table 4 Social security offices

Province	RAF	SASSA	UIF	Total
Eastern Cape	8	43	15	66
Free State	6	22	12	40
Gauteng	16	39	28	83
Kwazulu-Natal	14	76	17	107
Limpopo	11	79	12	102
Mpumalanga	13	16	16	45
North West	5	26	11	42
Northern Cape	5	22	7	34
Western Cape	9	35	13	57
Total	**87**	**358**	**131**	**576**

3.4 Supplementary retirement funds

Workers who earn above the tax threshold will need to make supplementary contributions over and above their NSSF contribution to ensure an adequate income in retirement and appropriate levels of insurance.

Such workers are usually enrolled in a retirement fund. Their NSSF contribution will be lower than the contribution to their existing arrangement. Government will continue to incentivise top-up contributions to an occupational fund or private arrangement through the tax system, although contributions above an upper limit will not be tax deductible.

A system of automatic enrolment is under consideration to encourage workers to make supplementary pensions and insurance contributions. Under such a system, an employer is obliged to enrol employees in the company's occupational scheme or another suitable arrangement in addition to their mandatory contributions to the NSSF, unless employees explicitly elect not to join. Employees may be permitted to choose their level of contribution.

Workers must have confidence in the pension arrangement to which they contribute. Their fund must be transparent, well administered, well governed and well regulated. Workers must trust that the fund is investing their contributions prudently, and with their best interests at heart. Fund members must know that they are receiving good value for money, and that asset management or administrative fees are not eroding their returns.

At present, too few fund members enjoy such peace of mind. They are usually enrolled in a fund as a condition of employment and have little influence on how the fund is run. In some cases, workers do not even know that they belong to a fund.

In 2010, some 3 000 active retirement funds were registered with the Financial Services Board (FSB), of which 80 per cent had 100 or fewer members. Many of these funds fail to submit their accounts to the FSB, making it difficult for the regulator to keep track of funds and oversee fund management.

Although there are regulations in place to protect retirement fund members, abuses will inevitably be committed when oversight is so difficult and the landscape is so fragmented. The IDTT has considered the establishment of a specialist regulator for social security and supplementary funds. This could involve bolstering the existing FSB or establishing a new agency. The NSSF will adhere to the same standards that are established for the approved funds operating in the new regulatory environment.

Approved funds framework

This paper proposes the introduction of an approved funds framework that will determine which funds are eligible for tax-incentivised supplementary savings. This framework will establish standards relating to disclosure, investment strategy, risk management, administration and governance.

Regulating governance will minimise potential conflicts of interest. The proposed framework will include principles of independence of the board and an appropriate balance of power between the boards of management and service providers. Multi-employer (umbrella) funds will be subject to specific governance provisions, such as requiring employer and employee member representation on the board of management.

One of the proposed qualifying criteria for approved funds is that they meet certain cost-efficiency standards. Consolidation of the private retirement fund sector into a smaller number of large employer-based retirement funds would achieve economies of scale, improve governance, and lower the costs of supervision.

The erosion of retirement savings through high costs is a particular concern in the voluntary savings environment, which is dominated by Retirement Annuities. Proposals for an individual retirement funds framework include portability with no early termination penalties; greater product standardisation and disclosure; limited charge structures; and stronger investment regulation, including limitations on individual investment choice.

It is proposed that the approved funds framework incorporate the mandatory preservation of retirement contributions and portability, with limited restricted withdrawals, to protect accumulated retirement savings from early withdrawals.

Annuitisation

Government proposes that it should be mandatory for retirement fund contributors to annuitise at least two-thirds of their supplementary retirement savings at retirement. This currently applies to pension funds but not to provident funds. Before this can be extended to all retirement funds, several fairness issues in the annuity industry need to be addressed that would make such products more appropriate for low-income earners.

Government is investigating whether it can provide an annuity product. This would pool mortality across the working population, provide protection against inflation and include an income for a spouse should the retiree die first. The monthly income would also be the same for men and women, which would be administratively straightforward and adhere to constitutional requirements of non-discrimination. At present, insurers pay larger monthly annuities to men than to women because women have a longer life expectancy.

Low-cost pension fund

Government will give consideration to establishing a low-cost pension fund to run alongside the NSSF and the approved funds. An administratively simple, low-cost arrangement would benefit self-employed or informal-sector workers, for example.

Such a fund would be run on a defined-contribution basis and without Government underwriting. It could also be a default destination for supplementary contributions made through automatic enrolment. Where an employer cannot enrol employees in an occupational fund, they would instead be enrolled in the default fund.

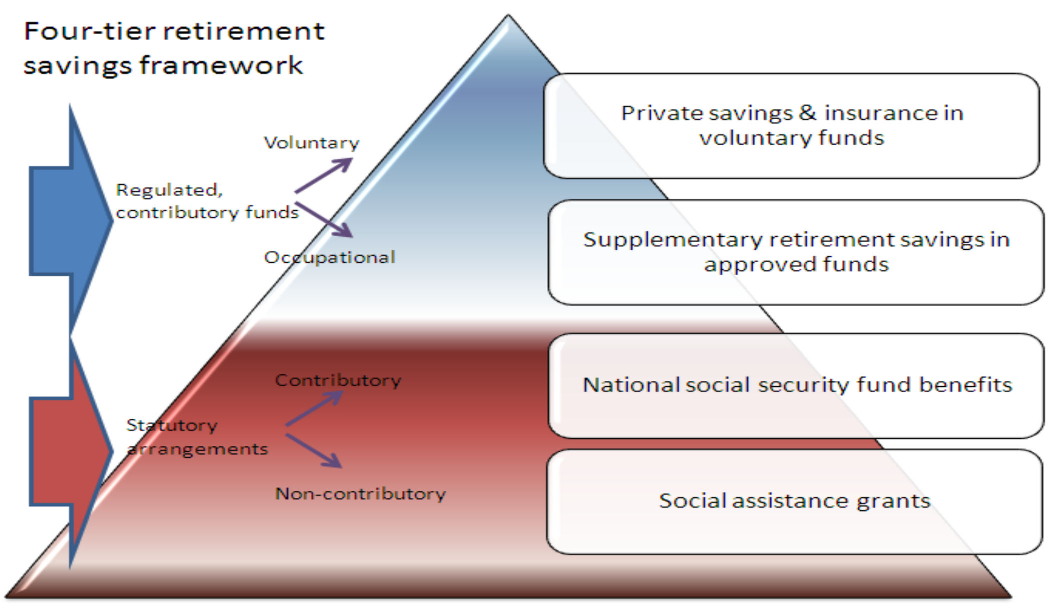
Vested rights

Where these proposals change conditions and benefit design of retirement and social insurance funds, the rights of current members and contributors who have accumulated funds or benefit entitlements under current rules will be assured. Members of retirement funds may be granted the opportunity to transfer accumulated retirement savings to the NSSF, but will not be obliged to undertake any actions related to accrued rights that might leave them in a poorer position.

A four-tier framework for retirement income

Under the proposals described in this section, workers' pension and insurance arrangements can be depicted as a four-tier system, as in Figure 5. Lower-income workers will rely on the grants system and the NSSF to provide income protection. At higher income levels, workers divide contributions between the statutory arrangement and regulated funds, and the financial responsibilities and risks shift from Government to the individual.

Figure 5 The retirement savings framework



4 Finance, institutions and the reform roadmap

4.1 Financing social security: long-term sustainability

The proposed social security system is a set of long-term commitments involving a complex interaction of social, demographic and financial factors. This section explains the design of the proposed system and discusses its financial sustainability.

The design of the NSSF and automatic balancing mechanisms

The design of the NSSF's benefit and contribution arrangements requires a balance between providing adequate income protection to contributors and guaranteeing the fund's long-term sustainability.

For the majority of workers, mandatory contributions to the NSSF will represent a significant outlay over the course of their careers. Individual contributors should receive an equitable return on their contributions.

They should also know their contributions are safe. In the envisaged defined-benefit arrangement, government will stand behind the system through the guaranteed accrual rate and the formulae for disability and survivor benefits. The state as guarantor will have responsibility for balancing contributions and benefits, which over the long term will have to be adjusted in response to demographic and other trends.

The fund will be run on a partially funded basis, which means that the contributions of today's workers will partially finance today's benefit recipients and partially contribute to an accumulation of assets to meet future requirements. The underlying principle is that the fund must at all times be able to meet its cash requirements. Preliminary actuarial modelling, drawing on international experience with similar arrangements, suggests that the NSSF should be subject to at least a 25 per cent minimum reserve requirement: accumulated funds (NSSF assets) should over the long term never fall below 25 per cent of the present value of accrued future benefits (NSSF liabilities). This design allows the NSSF to pay risk benefits to contributors as soon as it is established.

The NSSF has been designed to avoid the financial and economic risks inherent to unsound social security arrangements. If the system is jeopardised by unforeseen economic and demographic trends, the parameters of the fund (the contribution rate, benefit levels or eligibility criteria) will be adjusted to guarantee that the fund remains solvent and sustainable over the long term.

These changes should be made automatically, in terms of statutory requirements rather than discretionary procedures. In the absence of such rules, governments have often faced severe political difficulties in making the necessary changes to social security systems, resulting in a burden on future generations because of unaffordable benefits in the present.

The proposed reforms have potential macroeconomic effects, through their impact on savings rates, future consumption trends, government revenue and labour force participation. An increase in tax-incentivised savings together with mandatory preservation of retirement-fund accumulations and improved lifetime income security will be broadly beneficial for growth, though these are difficult trends to predict. The NSSF's future obligations will represent a significant implicit debt for the state, and the balance between contributions and benefits is an important element in long-term fiscal and financial sustainability.

Modelling carried out by the IDTT indicates that the NSSF is sustainable over the long term under a reasonable set of assumptions. Initially, there will be high demand for risk benefits, due to the high levels of morbidity and early mortality associated with South Africa's disease burden. Pension expenditure, meanwhile, will be low, since the NSSF will not start paying out retirement benefits immediately and because South Africa's labour force is relatively young.

Over time, this balance will change. The working-age population will start to live longer, leading to rising numbers of pensioners supported by a slower growing work force. Pension expenditure will increase while risk-benefit payments fall.

Social assistance

Non-contributory arrangements are financed from general tax revenue. At present, the cost of social assistance is projected only three years forward under the medium-term expenditure framework. Because social grants will work hand-in-hand with the NSSF to protect workers, it is important that the grants system be subject to the same long-term modelling requirements as the mandatory fund.

However, the social grants system is likely to be subject to further reform over the long term. It will remain Government's principal poverty reduction programme. As the economy develops and South Africa's demographic, health and social profiles change, different categories of income vulnerability may emerge. The social assistance system will adapt in response, either through amendments to grant entitlements, or through adjustments to discretionary relief measures.

Retirement age

The standard age of retirement from the contributory system (the NSSF and supplementary savings arrangements) is recommended at 65. However, it is envisaged that eligibility for the *old age grant* should remain at age 60.

The higher age is appropriate for the contributory system because it improves the affordability of the system – participants pay contributions for longer and receive benefits for shorter periods – and reflects the expectation of the longer average lifespan of those earning enough to participate in the contributory system against those who will rely only on social assistance. However, this retirement age is high given the relatively low life expectancy, underscoring the need for the NSSF to give due emphasis to survivor and disability benefits.

Gradually raising the retirement age over time to adjust to population ageing will be necessary, to ensure a reasonable balance between workers' contributions and the corresponding benefits that need to be paid over lengthening life spans.

Tax treatment

The tax system will play a central role in the new social security system. SARS will be responsible for collecting contributions to the NSSF and maintains records of supplementary pension and insurance arrangements. The tax system will incentivise retirement savings by making contributions to the NSSF and the supplementary arrangements tax-deductible; tax will only be paid when benefits are paid out.

Consideration is being given to converting the existing tax deduction system for retirement contributions to a tax credit equivalent. This will address concerns that the current system unfairly benefits middle- and high-income workers: the value of tax deductions based on employee contributions to retirement funds is determined by the marginal rates faced by the individual. Higher-income earners therefore receive greater benefits than lower-income earners.

A tax credit system sets the tax benefit independently from the marginal tax rate, resulting in a fairer outcome and less distortion in the choice between savings instruments.

Adjustments are also under consideration to align social assistance with the personal income tax structure. As part of this reform, the discrepancy between the eligibility-ages for the old age grant, the secondary personal income tax rebate and the proposed NSSF pension will need to be addressed. One option would be for the secondary rebate or old age grant to be available from the age of 60, but as an alternative to, and not in combination with, tax deductible retirement fund contributions.

Indexation

Indexation plays a key role in determining the level of benefits paid out both by the contributory and non-contributory system, and consequently helps determine long-term affordability.

Social security benefits in some countries are indexed to price or wage inflation. If benefits are linked to price inflation, recipients should be able to afford the same products from one year to the next. Wage inflation is usually higher than price inflation, reflecting the overall growth of the economy and the working population's improved standard of living.

A combination of indexes is also possible, or a variable adjustment formula, taking into account long-term system sustainability. Considerations relevant to social grants and the proposed NSSF are briefly discussed below.

Social grants

At present, there is no set rule for the rate at which social grants are changed. Government determines the rises in social grants on an annual basis. In recent years, grants have broadly kept pace with prices rather than wages. While indexation of benefits to wages is possible, it requires a stable and reliable index and would imply an uncertain additional expense for the fiscus.

Figure 6 illustrates the impact over the long term of grant increases above inflation. An annual increase of one percentage point above price inflation, for example, leads to expenditure on the *old age grant* of about 0.3 percentage points more, relative to GDP, than if the grant were to increase in line with prices only.

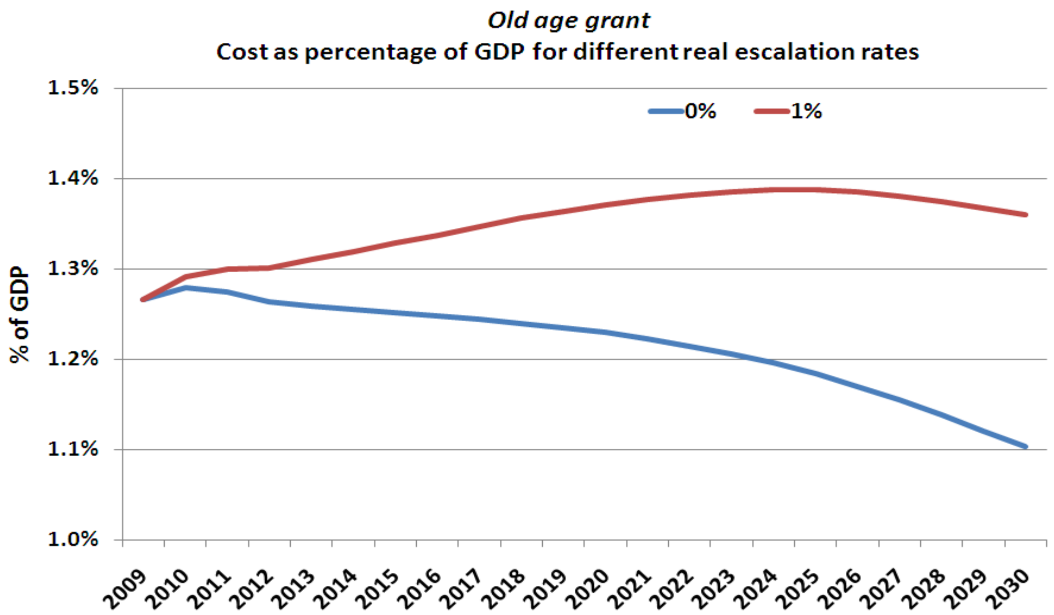
NSSF

Indexation of the NSSF underpins the calculation of benefit payments and valuing the contributions made over the course of a career. Survivor and disability benefits, which are based on the worker's most recent salary, will be adjusted each year according to the index chosen.

Retirement benefits are more complicated. Indexation affects both career-average earnings and adjustments to the pension in payment. It is intuitive that the present value of a worker's earnings during their career should be calculated using the wage index.

However, it is possible that changes to the structure of the workforce or poor economic performance might lead to declines in average wages, at times. A wage index would therefore undervalue a worker's contributions over the course of their career, and might also lead to an annual reduction in pensions in payment. A form of indexation that guarantees a fair return on contributions and protects the value of pensions in payment will be required.

Figure 6 Indexation of the old age grant



Long-term modelling

Government recognises the importance of long-term sustainability of social security and other fiscal commitments. Work is therefore in progress to monitor demographic and economic changes that could have an impact on fiscal sustainability, savings and economic growth.

This analysis will form part of the broader assessment of activities of government at national, provincial and local level that might have long-term consequences, and its scope could include state-owned entities. Publication of long-term fiscal and financial projections, and independence of such analysis, is crucial for good governance and effective management of fiscal and financial risks.

4.2 Impact of the NSSF on existing contributory funds

Introduction of the NSSF will have a significant impact on existing retirement and insurance arrangements, especially those catering for lower-income workers who will struggle to make contributions over and above their NSSF obligations. This impact requires careful analysis and consultation with those likely to be affected.

Occupational and voluntary funds

The first ten per cent of all workers' retirement contributions on earnings up to the NSSF ceiling will go to the mandatory fund rather than to their present retirement arrangements (with the two per cent unemployment insurance contribution as before). As a result, occupational and voluntary funds will suffer a significant loss of business: they will henceforth be competing for supplementary savings over and above workers' contributions to the NSSF.

Existing pension and provident funds, including defined-contribution plans offered by the majority of companies and defined-benefit public-sector funds, will need to adapt their contribution and benefit structures to take account of the new mandatory social security arrangement. A reasonable transition period for these changes will be established as part of the reform process.

The new environment will be particularly challenging for funds which cater for workers earning below the NSSF ceiling, or those with contribution rates that are not significantly above the mandatory level. Bargaining council funds, with an average contribution rate of 12.9 per cent, will be more affected than private-sector funds, whose average contribution rate is 15.8 per cent and who typically cater to higher-income earners.

It should be noted, however, that a significant proportion of bargaining council members will be eligible for the contribution subsidy, which will make contributions to the NSSF more affordable and will allow them to make supplementary contributions to their council funds. Where funds are unable to operate in the new environment, workers will have access to alternative private funds or a default arrangement for supplementary retirement savings.

It is important that the introduction of the NSSF should not lead to an overall reduction in household savings. This might occur if workers do not make supplementary contributions in the belief that the NSSF will provide a sufficient income in retirement and adequate risk benefits. Workers will therefore be urged to maintain or even increase their existing contribution levels, and will be encouraged to do so via a system of automatic enrolment.

Public sector funds

The Government Employees Pension Fund (GEPF) is the largest pension fund in Africa, with 1.2 million members and assets in excess of R790 billion. It is established in law and currently is neither subject to the Pension Funds Act nor regulated by the Financial Services Board.

There are also several public sector funds for state-owned enterprises, as well as 32 active retirement funds for local government employees, which control assets worth some R62 billion. These funds, which can be either defined-benefit or defined-contribution arrangements, cover more than 300 000 employees and are regulated by the FSB. Some are managed by unions.

Public sector funds will be significantly affected by the introduction of the NSSF. Their present contribution base will partly go to the new NSSF arrangement, with the remaining part converted into a supplementary fund complying with the approved funds framework. A first step towards these changes will be the extension of the Pension Funds Act to cover all currently exempt public sector funds.

There will also be implications of the reform of unemployment insurance and compensation fund arrangements for the public service, if full alignment between the public and private sector is to be realised.

4.3 Institutional framework

South Africa's social security system has evolved in an uncoordinated manner across a number of different government departments and agencies leading to disjointed policy-making, incoherent administrative arrangements and poor service delivery.

Existing social security institutions are large and complex, and their reform will require a new legal framework, as well as changes to their management and governance. Social security reforms must take cognisance of:

- Constitutional provisions outlining rights and obligations in relation to both entitlements and procedural fairness
- Legislative arrangements, including entitlements and administration, also taking into account international agreements
- The organisation of policy-making structures
- Regulatory and oversight arrangements
- Organisations and administrative systems
- Governance arrangements
- Judicial and semi-judicial arrangements for review and settlement of disputes.

The development of a comprehensive social security system will involve the establishment of a unified policy platform for social security. This will then oversee the proposed consolidation of existing institutions and the establishment of the NSSF.

Unified policy-making, consolidated systems

The aim of the proposed institutional framework is to facilitate unified and coherent policy-making across social security entities. It will also involve the consolidation of systems, while providing for the additional requirement of a centrally managed mandatory pension system.

The social security system proposed in this paper requires the following principal arrangements:

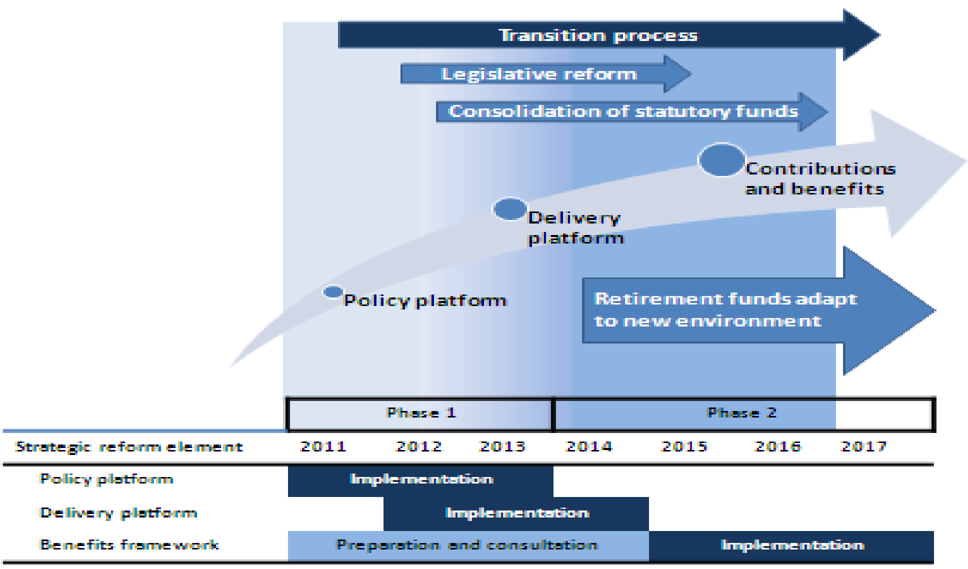
- *The establishment of a single department with oversight for social security.* This department will serve as the point of policy coordination for the social security system. It will be responsible for ensuring that all aspects of the system work efficiently and coherently to achieve the goals of social security, and that the system complements labour-market initiatives as well as broader government projects and priorities.
- *The National Social Security Fund:* The NSSF will be created in law, providing for mandatory contributions and pension, disability and survivor benefits, as well as administration arrangements, investment of funds, independent actuarial oversight and governance by a board of trustees.
- *Single collection agency:* SARS is proposed as a single collection agency, with employer and employee contributions gathered mainly through the monthly PAYE system. SARS could also collect supplementary contributions made through automatic enrolment or voluntary arrangements.
- *A new regulatory framework*: New regulations and an appropriate supervisory institution are required to ensure that the NSSF, social insurance funds and supplementary retirement arrangements comply with their legal obligations. Such a regulator would

be empowered to provide proactive supervision and ensure sound corporate governance for the entire social security system.

- *Unified payments arrangement:* As the largest payments provider in the country, SASSA is the institutional foundation on which an integrated payments administration will be built.
- *Master social security registry:* A master social security registry will maintain individual records of all social security contributors and beneficiaries, based on the official Home Affairs population register and supplemented by information from SARS, SASSA, employers, the UIF and other funds.
- *Consolidated public interface for social security:* A consolidated agency interface will provide client interaction and service, front-end enrolment, and education and awareness programmes. It will draw on labour centres and offices currently run by SASSA and other entities. South Africans will be able to access the system at physical offices, or over the telephone or the internet. This interface will be linked to public employment services to ensure social security recipients remain in close contact with labour-market initiatives.
- *Social security tribunal:* A tribunal is proposed to deal with disputes and appeals, with appropriate statutory powers and independence from the NSSF administration.
- *NSSF investment management:* Provision will be made in law for the investment of funds of the NSSF, subject to a transparent and responsible investment mandate and under regulatory oversight applicable to similar financial sector institutions. Steps will be taken to ensure adequate diversification of assets and to prevent social security funds from playing a dominant role in capital markets.

Social security and approved pension funds have a shared interest in administratively efficient registry and payments arrangements. A common 'clearing house' system, operating off a single IT platform, might be cost-effective and institutionally viable, while providing for competition between participating occupational and independent funds. Further work is needed to explore this option.

Figure 7 Proposed NSSF reform path



4.4 Consultation and provisional reform timetable

The reforms proposed in this paper constitute far-reaching modifications to South Africa's social security system and will have a significant impact on every sector of society. After this paper is published for public comment and feedback on these proposals is received, Government will engage stakeholders in an intensive consultation process to ensure that these proposals are right for the country as a whole.

Consultation between the social partners will be facilitated through a task team of the National Economic Development and Labour Council (Nedlac). The IDTT will coordinate a series of consultative forums on the reform proposals and a feedback process through web-based technologies to ensure that the views of retirement fund members, organised labour, business and community groups are heard by the proponents of the reforms. The contributions of all stakeholders will inform a final policy framework and legislation.

Implementation

The proposed social security system cannot be introduced overnight. A long-term implementation plan is needed that maps out the legislative and institutional reforms and establishes a timeline for the transition to a new savings landscape associated with the NSSF and the approved funds framework.

Subject to the completion of the consultation process that begins with the publication of this paper, Government's proposed implementation strategy will be sequenced in three broad phases:

(1) Creating a unified policy platform

A department responsible for social security will be established. This department will initiate the drafting of legislation associated with the new comprehensive social security landscape and develop implementation plans. The legislative process will create the basis for the institutional reorganization.

(2) Establishment of the NSSF and institutional consolidation

The NSSF will be established and will be aligned to the social insurance funds and social assistance platform. Systems across the different entities will be integrated according to a new IT architecture.

(3) Five-to-ten year transition for implementation of the NSSF

Once a department responsible for social security policy-making and the NSSF are in place, a transition period of between five and ten years is proposed for alignment of existing retirement funds with the NSSF and the approved funds framework.

5 Conclusion

The present social security system in South Africa falls short of its Constitutional requirements. This paper has identified the key weaknesses of the existing social security arrangements and proposed measures by which to address them:

- *The absence of a statutory pension and insurance arrangement.* The NSSF will pay benefits on retirement, disability, death prior to retirement or unemployment. It will be available to all workers and funded by mandatory contributions.
- *Limits to the reach of social assistance*. The gradual elimination of the means tests for social grants, together with a standardized disability assessment, will ensure all those who are in need of social assistance receive it.
- *Fragmentation of social security arrangements*. The establishment of a single department responsible for social security will unify policy making. Shared administration and services will improve efficiency and service delivery across the agencies and significantly reduce costs.
- *Variable quality of coverage in private-sector arrangements*. The approved funds framework will ensure that only well-run and transparent voluntary retirement and insurance arrangements will be eligible for tax-incentivized contributions.
- *Lack of coherence with the labour market*: The department responsible for social security will ensure that its policies are closely aligned with labour-market policies as well as broader Government priorities. A sharing of facilities between social security agencies and labour centres will enhance workers' access to both and will expand the footprint of public employment services.

This paper proposes other measures that will support this reform agenda:

- A *contribution subsidy* that will encourage low-income workers to join the NSSF and mitigate any adverse effects to the labour market associated with mandatory contributions.
- The *extension of UIF benefits*, including a *continuation benefit* for workers who have exhausted their full UIF benefits, to be paid at a lower rate and linked to labour activation measures to protect workers from having to draw down their retirement savings.
- The establishment of a *Road Accident Benefit Scheme* to replace the current Road Accident Fund.
- The inclusion of *government employees in the UIF and COIDA*.
- *Alignment of social security with NHI*, especially for the medical benefits presently covered by the compensation funds and RAF.
- *Preservation and portability of retirement savings* to ensure workers do not liquidate their accumulations until they reach retirement except in the event of a life crisis.
- *Automatic enrolment* to encourage workers above the tax threshold to contribute to supplementary retirement and insurance arrangements.
- A *low-cost retirement savings arrangement* for supplementary contributions that would also cater for low-income workers and the self-employed.
- A *government-backed annuity product* designed for workers earning below the NSSF ceiling.

These proposals are intended to ensure that every worker enjoys access to effective social security arrangements. However, they are significant in scope, and, if they are poorly designed or poorly implemented they risk significant adverse consequences for the economy and for future generations of workers.

These proposals therefore require careful consultation with the public and community organisations, business and trade unions, the retirement fund industry and regulatory bodies.

This discussion paper is the first stage in the consultation process. The IDTT trusts that this document provides a sound platform for the critically important interaction that lies before the social partners (government, business, community and labour) and all those with a stake in South Africa's social security system. We welcome all thoughts and comments in response to this paper.

'The future we choose today will determine the kind of South Africa our children and their children will live in. The prospect of prosperity for all is a struggle worth fighting with all the will and determination that we can muster. We must give real meaning to justice. For with jobs comes dignity. With dignity comes participation. And from participation emerges prosperity for all!' – Pravin Gordhan, Minister of Finance

Glossary

Approved funds	Private arrangements authorised to manage tax-incentivised savings.
Beneficiaries	People who are entitled to social security benefits
Ceiling	The maximum income at which social security contributions are mandatory.
Contribution floor	The income level above which social security contributions are mandatory.
Contribution subsidy	A form of government incentive to participate in the system, under which part of the contribution to the mandatory retirement system is paid by government.
Contributors	Persons or entities required to make social security contributions.
Defined-benefit	A retirement or social security arrangement in which the level of benefits is based on a pre-determined formula. Benefits can be either flat rate or earnings-related.
Defined-contribution	A retirement arrangement in which benefits depend on the value of contributions plus investment returns, less operating expenses.
Financial Services Board	The regulator or South African financial services entities, excluding banks.
Income smoothing	The levelling out of fluctuations in lifetime income, usually achieved by workers allocating part of their salary to insurance against unemployment and disability, and to a pension, so that they receive an income when they are unable to work.
National Health Insurance	A statutory health care financing system that insures the whole population for the cost of healthcare, and administered by the public sector, private sector or a combination of both with a view to ensure universal access to healthcare to all South Africans.
National Social Security Fund	A proposed statutory fund to be established by government to manage mandatory retirement benefits, risk benefits and unemployment insurance.
Pay as you go	Any system of retirement or risk benefits paid from current contributions rather than being funded in advance from contributions paid while earning.
Social wage	Amenities that accrue to citizens through public funds, such as social grants and the provision of services such as education, health care, and housing.
Social security contribution	A member's legally required contribution to social security.
Threshold	In this report, refers to a contribution parameter defined either as a rand amount or as a percentage of the member's gross income.

Acronyms

FSB	Financial Services Board
GDP	Gross domestic product
ILO	International Labour Organisation
NHI	National Health Insurance
NSSF	National Social Security Fund
RABS	Road Accident Benefit Scheme
RAF	Road Accident Fund
SARS	South African Revenue Service
SASSA	South African Social Security Agency
UIF	Unemployment Insurance Fund