6

Social security

- Strong growth in social assistance grants expenditure has contributed significantly to poverty reduction and broadening income security over the past decade. Progressive extension of the social security net will continue over the period ahead, including a phased equalisation of the old age grant qualification age for men and women, higher means test thresholds and an extension of the child support grant to the age of 15 in 2009. Strengthening of the South African Social Security Agency and consolidation of benefit payment arrangements are also in progress.
- The introduction of new administration systems at the Unemployment Insurance Fund has significantly improved service delivery, both in terms of contributor enrolment and benefit disbursement. Similar systems re-engineering is under way for the Compensation Fund.
- In March 2008, Statistics South Africa will introduce an official poverty line index pilot, complementing its contribution to monitoring living standards through household surveys.
- The social security and retirement reform process is coordinated by a government task team. Consultation on draft reform proposals flowing from this process will continue in 2008.

Poverty reduction and social protection

Towards comprehensive social security

Expansion of the social assistance safety net has been prioritised over the past decade, and the number of beneficiaries has increased from fewer than 3 million in 1997 to an expected 12.4 million in April 2008. Consolidated expenditure on welfare and social security has increased from R23.6 billion in 1997/98 (3.4 per cent of GDP) to a projected R105.2 billion in 2008/09 (4.6 per cent of GDP).

More than 12 million South Africans are now benefiting from social assistance

Broadening social security is central to government's anti-poverty strategy

Alongside the challenges of job creation and improving the earnings of low-income workers, broadening social security provision is central to government's anti-poverty strategy.

Old age pension grant qualifying age to be equalised

An initial step in the social security reform process will be the phased equalisation of the qualifying age for old age grants to 60 years for both men and women by 2010/11, together with reform of the social assistance means tests. In 2009 the child support grant will be extended to age 15, following a review of conditions to be attached to the grant to be conducted in 2008. Also under consideration are options for extending and improving unemployment insurance. Progress has been made towards agreement on design options for a basic social security contribution and standard benefits, while further research and consultation is required on institutional arrangements and governance, and the design and regulatory reform proposals for private retirement funding arrangements.

Social security reforms should help to strengthen labour market participation

The reforms should support employment creation by strengthening participation in the labour market. Links between social security reform and employment, and the possible design and impact of a wage subsidy implemented through the PAYE system, have been explored. The tax treatment of retirement fund withdrawals is being revised (see Chapter 4), and options for further reform of the taxation of retirement savings contributions and benefits are under review.

Household income and living standards

Poverty reduction comprises wide range of policy interventions

Under the leadership of the Policy Coordination and Advisory Service in the Presidency, South Africa's anti-poverty strategy comprises several interconnected initiatives. Job creation and interventions focused on the informal economy, education and skills development, housing and basic services, land redistribution and rural development all contribute to broadening opportunities and sustainable development. Social cohesion and community development projects – including adult education, early childhood development and community policing initiatives – contribute to the mobilisation of resources and construction of partnerships at local level.

Progress in improving housing and access to services since 2002 is summarised in Table 6.1, together with the trend in reported child hunger, which is a key poverty indicator. Trends in the reported use of health and welfare services in recent years are illustrated in Table 6.2.

Table 6.1 Household living standard indicators, 2002 – 2006

% of households	2002	2003	2004	2005	2006
Type of housing: informal	12.7	12.5	11.3	11.7	8.7
Access to services:					
Electricity connection	76.1	77.6	80.4	80.2	80.2
Water supply on site	66.1	67.3	67.8	68.4	71.3
Cellphone availability	35.0	40.2	49.6	59.7	70.2
Child hunger in prior 12 months (as % of households with children):					
Never went hungry	68.8	69.9	73.9	76.8	84.0
Often or always went hungry	6.7	7.0	5.1	4.7	2.4

Source: Statistics SA, General Household Surveys, 2002 – 2006

Table 6.2 Access to health and welfare services, 2002 – 2006

% of population	2002	2003	2004	2005	2006
% of population who used health services in month prior to survey:					
Public	5.4	5.4	5.6	6.1	6.4
Private	4.0	4.0	4.0	4.2	4.0
% of population who used welfare services in previous 12 months:					
Social worker / other service	1.1	1.5	1.8	1.7	1.3
Social grants	3.2	6.5	9.4	12.9	12.5
Total population (thousands)	45 533	46 007	46 459	46 913	47 391

Source: Statistics SA, General Household Surveys, 2002 – 2006

Understanding the extent and nature of poverty and inequality in South Africa is the key to developing evidence-based policies and programmes for poverty reduction. Alongside its continuing contribution to this effort through household and living standards surveys, Statistics South Africa (Stats SA) will introduce an official poverty line index in March 2008. During its pilot phase, Stats SA will continue to solicit public input on the design of this measure.

A poverty line for South Africa

Following publication of a consultation document on a proposed poverty line for South Africa in February 2007, Stats SA has engaged in wide-ranging and constructive dialogue on the design and purpose of such a measure. Stats SA has revised the February 2007 proposals to take into account stakeholder comments and updated data.

The proposed poverty line is based on standard international methodology. It consists of a food requirement and a non-food requirement. The food element is determined by estimating the cost of a minimum basket of food that meets the daily energy requirements of an average adult. The composition of this basket is derived from household food consumption as reported in the General Household Survey. The non-food component is also based on patterns recorded in this survey.

Social assistance

Social grants and household welfare

Social assistance cash grants provide income support to people whose livelihoods are most at risk. The available grants are the old age pension; the disability, child support, foster care, care dependency and war veterans' grants; grant-in-aid and social relief.

Cash grants provide income support to those whose livelihoods are most at risk

Social grants administered by the South African Social Security Agency (SASSA) are the most important part of the present social security system, amounting to more than 3 per cent of GDP and reaching over 12 million beneficiaries. Recent research has reconfirmed that the grants system is well targeted at the poorest households, and significantly reduces the extent and severity of income poverty.[1]

[1] Van der Berg, S., Louw, M. and du Toit, L. 2007. 'Poverty Trends Since the Transition: What We Know.' Stellenbosch University.

Targeting social grants: costs versus benefits

Arguments for and against the targeting of social grants through means tests have recently been reviewed in a report prepared for the Department of Social Development.

The present means test applicable to the old age pension and the disability grant takes into account both an applicant's regular income and the value of assets such as investments or residential property that generates rental income. For 2007/08, the means test for a single person imposes a 50% clawback on income above a threshold of R261 a month (30 per cent of the maximum grant value), up to an exclusion level of R1 801 a month. Applied to the joint income of two persons, the test imposes the same reduction in grant value as would obtain if the joint income were equally divided between two single persons.

For the child support grant, two income thresholds are applied: a monthly household income of R1 100 in rural areas and informal urban settlements, and of R800 in formal urban neighbourhoods. The care dependency grant for disabled children can only be received by those who, together with their spouses, earn an income of less than R48 000 per annum.

In practice, the means tests are difficult to administer rigorously and consistently, and the failure to adjust the income thresholds for the child support grant since its introduction means that they are now unrealistically low. The difficulties of applying the means tests fairly, the administrative costs associated with the test, and the disincentives to saving of the current system are compelling arguments for reform.

However, the costs of fully eliminating the means tests would be high, with the benefits largely going to the non-poor. Consideration is therefore being given to a phased adjustment of means test thresholds, with a view to narrowing the gap between the grant exclusion levels and the thresholds applicable to personal income tax (R43 000 a year in 2007/08, or R69 000 a year for taxpayers over the age of 65).

Government proposes to raise means test thresholds for certain grants

Targeting of social assistance, however, leads to some difficulties. Government's task team on social security and retirement reform has examined the present means tests that apply to the old age pension and other social grants. They are difficult to administer and have unintended consequences, such as effectively penalising saving for retirement by low-income workers. Government proposes to raise the means test thresholds for the old age and disability grants and the household income limits for the child support grant. Details will be published by the Minister of Social Development.

Eligibility for child support grant to be extended to 15 and qualifying conditions to be reviewed

It is proposed that the eligibility age ceiling for the child support grant should be raised from the 14th to the 15th birthday with effect from January 2009. Drawing in part on international experience, a review will be undertaken this year of the grant's administration and targeting mechanisms, and of appropriate conditional criteria, such as school attendance and immunisation of qualifying children.

The qualifying age for old age grants currently stands at 65 years for men and 60 years for women. Social conditions and labour market trends have changed considerably since these thresholds were determined. The differentiation in qualifying age for the social pension is no longer appropriate, and it will be phased out over the medium-term expenditure framework (MTEF) period. In 2008/09, eligibility will be extended to men aged 63 and 64 years, in 2009/10 to those aged 61 and 62 years and in 2010/11 to men over the age of 60, subject to amendment of the Social Assistance Act (2004).

In coming years it will be necessary to revisit the retirement age

Beyond 2010/11, it will be necessary to reconsider the old age grant qualifying age. Rising life expectancy and improvements in employment and social conditions will in years to come necessitate upward adjustments to the normal age of retirement. In keeping with international practice in this regard, these changes will be made gradually, announced well in advance.

South African Social Security Agency

Social grants administration has been successfully consolidated in one agency

SASSA has successfully consolidated social grants administration following the shift of this function from provinces. It has focused efforts over the past year on operational continuity, while beginning to build the necessary capacity for longer-term improvements in efficiency and effectiveness.

Integrity and reliability of social grants administration are critical given the scale of the social assistance system and associated fiscal risks. Priority initiatives include extending the number and convenience of access points; improving services to beneficiaries who receive grants in unsatisfactory conditions; upgrading administrative facilities and increased use of mobile units in rural areas. Work is also in progress to modernise social grants administration, and to review the associated regulations, norms and standards.

New grants administration system being implemented to improve service delivery

An improved grants application process project is under way to address long turnaround times, communication failures, fraud and uneven service standards. This initiative aims to standardise part of the application process by centralising the registry and decentralising the verification and approval of applications. The goal is to reduce the application-to-approval process duration to one day and reduce fraud.

Overall administration costs of R4.5 billion are provided for in the 2008 Budget, rising to R5.2 billion in 2010/11. Independent payment service provider contracts, which cover about 76 per cent of payment transactions, account for just over half of projected administration spending. Allocations are made for further investment in system improvements and increased capacity.

Expenditure on social assistance and its administration is summarised in Table 6.3. Spending is expected to grow from approximately R75.3 billion in 2008/09 to R89.5 billion in 2010/11, and to remain at about 3.3 per cent of GDP.

Table 6.3 Social assistance expenditure, 2004/05 – 2010/11

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
R million				Preliminary outcome	Medium-term estimates		
Social grant expenditure	44 885	50 708	57 032	62 445	70 726	78 120	84 295
SASSA administration	2 178	3 324	3 819	4 520	4 541	4 883	5 205
Total	47 063	54 032	60 851	66 965	75 267	83 003	89 500
Total as percentage of GDP	3.3%	3.4%	3.4%	3.3%	3.3%	3.3%	3.2%

Source: Estimates of National Expenditure

Social assistance beneficiary and expenditure trends

Largest number of grants reaches caregivers of children under age 14

The growth in social grant beneficiary numbers since 2004 is shown in Table 6.4, together with projections for the MTEF period ahead. The number of beneficiaries is expected to reach 12.4 million by April 2008. The largest number of grants goes to caregivers of children under the age of 14, followed by the elderly and those with disabilities. The average annual growth in the number of beneficiaries was 11.8 per cent over the four-year period to April 2008.

Table 6.4 Social grants beneficiary numbers by type of grant, 2004 – 2008

Type of grant	April 2004	April 2005	April 2006	April 2007	April 2008 projected	% growth (average annual)
Old age	2 060 421	2 093 440	2 144 117	2 195 018	2 225 354	1.9%
War veterans	3 961	3 343	2 832	2 340	1 931	-16.4%
Disability	1 270 964	1 307 551	1 319 536	1 422 808	1 409 434	2.6%
Grant-in-aid	18 170	–	–	–	–	–
Foster care	200 340	252 106	312 614	400 503	446 994	22.2%
Care dependency	77 934	88 889	94 263	98 631	110 153	9.0%
Child support	4 309 772	5 661 500	7 044 901	7 863 841	8 208 334	17.5%
Total	**7 941 562**	**9 406 829**	**10 918 263**	**11 983 141**	**12 402 200**	**11.8%**
Province						
Eastern Cape	1 501 031	1 743 007	2 094 642	2 244 303	2 301 041	11.3%
Free State	503 063	596 083	678 522	723 698	755 665	10.7%
Gauteng	976 533	1 165 679	1 318 981	1 406 445	1 451 967	10.4%
KwaZulu-Natal	1 836 975	2 149 969	2 498 888	2 931 722	3 042 607	13.4%
Limpopo	1 152 621	1 412 882	1 640 032	1 751 512	1 803 430	11.8%
Mpumalanga	580 684	704 070	836 451	901 386	929 743	12.5%
Northern Cape	169 102	188 578	213 512	232 102	307 095	16.1%
North West	637 312	777 722	888 065	1 001 629	980 018	11.4%
Western Cape	584 241	668 839	749 170	790 344	830 634	9.2%
Total	**7 941 562**	**9 406 829**	**10 918 263**	**11 983 141**	**12 402 200**	**11.8%**

Source: Socpen system

The rand values of grant awards are adjusted each year for inflation. The maximum values of social assistance grants since 2003 and proposed values to take effect in April 2008 are set out in Table 6.5. The child support grant will increase on 1 April 2008 by R10 per month to R210 and from 1 October 2008 by another R10 per month to a value of R220.

Table 6.5 Values of maximum social grants, 2003 – 2008

	Rand value of grants, per month, with effect from April					
Type of grant	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Old age	700	740	780	820	870	940
War veterans	718	758	798	838	890	960
Disability	700	740	780	820	870	940
Grant in aid	150	170	180	190	200	210
Foster care	500	530	560	590	620	650
Care dependency	700	740	780	820	870	940
Child support grant	160	170	180	190	200	215*

** R210 with effect from April 2008, R220 from October 2008*

Social assistance grants for children

Over the past 10 years, government has progressively widened the safety net for children through the care dependency, child support and foster care grants. The child support grant has been central to this. It was introduced in 1998 for eligible children up to their 7th birthday, and has gradually been extended to include children up to 14 years. The number of recipients has grown at an average annual rate of 17.5 per cent, from 4.3 million children in April 2004 to a projected 8.2 million in April 2008.

The number of care dependency grant beneficiaries is expected to grow from 77 934 in April 2004 to about 110 000 in April 2008. This grant is payable to parents or caregivers of children between ages 1 and 18 years who are in permanent home care and who suffer from severe mental or physical disability. It is means tested.

Number of care dependency grants is expected to reach 110 000 in early 2008

The foster care grant is for children whom the courts deem in need of care. The child is placed in the custody of a foster parent, designated by the court and under the supervision of a social worker. The aim of the grant is to reimburse non-parents for the costs of caring for a child, and it falls away in the event of adoption. The number of children in foster care has grown from 200 340 in April 2004 to about 446 900 in April 2008, an average annual increase of 22 per cent.

Social security funds

Contributory social security funds provide conditional income support or compensation for defined-risk events. The present social security schemes include the Unemployment Insurance Fund (UIF), the Compensation Funds and the Road Accident Fund (RAF). They are financed through mandatory levies and taxes.

These funds are expected to run a combined cash surplus of about R4.2 billion in 2008/09, compared with a surplus outcome of about R4.5 billion in the previous financial year. This reflects continued substantial cash surpluses at the UIF and Compensation Funds, while expenditure on claims payments has outstripped revenue of the RAF. The overall balance of the social security funds is expected to remain in surplus over the forecast period.

Overall surplus of about R4.2 billion in social security funds in 2008/09

Unemployment insurance

The UIF provides short-term unemployment insurance to qualifying workers. It pays benefits to contributors or their dependants in cases of unemployment, illness, maternity, adoption of a child or death. The fund is financed by a tax payable by both employers and employees at a rate of 1 per cent of earnings, up to a threshold of R12 478 a month.

The UIF's turnaround strategy has yielded positive operational and financial results, including unqualified audit reports for the past two years. The fund has implemented a new business application system, *Siyaya,* with an integrated financial system across all of its structures, and has put in place an electronic funds disbursement system. These reforms have assisted both in improving the quality of the service

The UIF's turnaround is supported by the Siyaya business application system provided, and in rapidly enrolling household sector and agricultural employees, who were previously outside the formal UIF system.

By end-March 2007, the UIF had R18.5 billion in capital and reserves

The March 2007 actuarial valuation indicated that the UIF is in a position to meet its cash-flow requirements over the next 10 years for a wide range of possible claims scenarios. The actuarial reserve requirement was estimated at R10.7 billion. By the end of March 2007, the fund had accumulated R18.5 billion in capital and reserves, with an estimated R20 billion invested with the Public Investment Corporation.

Table 6.6 Social security funds, 2004/05 – 2010/11

R million	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
		Outcome		Revised estimate		Medium-term estimates	
Unemployment Insurance Fund							
Revenue	6 810	7 841	9 467	10 087	10 965	11 914	12 959
Expenditure	2 981	3 635	3 578	6 258	7 334	8 141	7 839
Compensation funds							
Revenue	3 023	3 652	3 724	4 543	4 827	5 109	5 412
Expenditure	2 354	2 858	2 912	2 926	3 328	3 496	3 698
Road Accident Fund							
Revenue	4 524	8 763	7 256	7 835	8 890	10 234	11 665
Expenditure	3 659	6 210	7 545	8 796	9 792	10 883	12 258
Total: Social security funds							
Tax revenue	6 731	8 845	9 854	11 091	12 364	13 909	15 557
Non-tax revenue	1 551	1 821	2 593	2 704	3 042	3 422	3 907
Grants received	12	2 708	11	10	11	11	11
Unemployment contributions	6 063	6 882	7 989	8 661	9 267	9 915	10 560
Total revenue	**14 357**	**20 255**	**20 447**	**22 465**	**24 683**	**27 257**	**30 035**
Total expenditure	**8 994**	**12 702**	**14 035**	**17 979**	**20 454**	**22 521**	**23 795**
Budget balance[1]	**5 363**	**7 553**	**6 412**	**4 486**	**4 229**	**4 736**	**6 241**

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

Compensation Funds

Compensation for occupational injuries and disease is financed through levies on employers

The Compensation Funds provide medical care and income benefits to workers who are injured on the job or who develop occupational diseases; survivor benefits to families of victims of employment-related fatalities; and funding for rehabilitation of disabled workers. Costs are recovered through levies on employers. The main Compensation Fund is administered by the Department of Labour and serves employees outside of the mining and construction sectors, which are covered by independently administered compensation arrangements. In respect of lung diseases contracted as a result of working conditions, other legislation provides for a Mines and Works Compensation Fund administered by the Department of Health.

Legislative and administrative reform of Compensation Funds needed

The Mines and Works Fund is responsible for in excess of 30 000 claims a year based on assessments conducted by the Medical Bureau for Occupational Diseases, while the Compensation Fund receives an average of 20 000 claims a month. There are material inconsistencies between the two legislative dispensations, the administration of compensation claims and benefits is in need of overhaul.

Restructuring of the main Compensation Fund is in progress, following initiation of a turnaround strategy in July 2007. Upgrading of the financial system to enhance service delivery commenced in January 2008. Over the past year, 73 per cent of backlog claims from 2000 to 2004 have been processed. Cheque payments were discontinued and replaced by electronic payment from September 2007. About 60 per cent of claims can now be disposed of within 90 days of receipt of complete documentation.

The main Compensation Fund is being restructured

The main Compensation Fund has seen an increase in employer registration, contributing to the improvement in revenue collection. For the year ended March 2007, the Compensation Fund paid R2.6 billion in benefits, compared with R2.4 billion in the previous year. As of March 2007, the funds had a combined accumulated surplus of R7.2 billion compared with R6.3 billion in the previous financial year.

Road Accident Fund

The RAF is financed through a dedicated fuel levy, set at 41.5 cents per litre of petrol and diesel sold for the 2007/08 year. The levy will increase by 5 cents a litre with effect from 2 April 2008. The RAF currently provides unlimited liability insurance in the form of compensation for loss of earnings and support, general damages, and medical and funeral costs to victims of road accidents caused by third parties.

The RAF's turnaround strategy has resulted in significant improvements in risk management and control. Progress has been made in the settlement rate, with the number of claims outstanding in 2007/08 reduced to 341 146 – a 23.5 per cent improvement. Revenue growth is expected to average 14.2 per cent annually from 2004/05 to 2010/11 due to increases in the fuel levy and in the volume of sales. This has improved the financial position of the RAF, but its accumulated deficit of R20.2 billion in 2006/07 is a clear indication that further reforms are needed.

RAF turnaround strategy making headway, but increasing number of claims is not sustainable

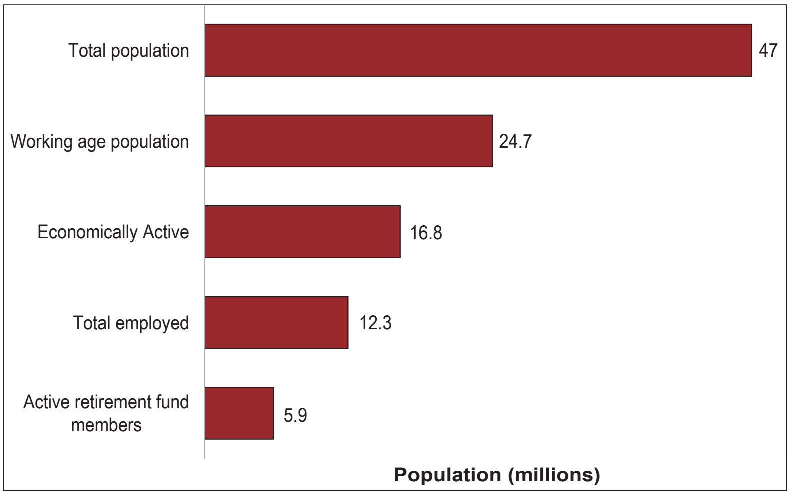
The growth in liabilities is partially addressed by the RAF Amendment Act (2005), which puts limits on the entitlement to general damages to ensure that expenditure is directed to those seriously injured. However, key sections of the Act have not been promulgated as a result of legal challenges, difficulties associated with assessment for injuries and negotiation of tariffs for emergency medical treatment. Further steps towards the envisaged road accident benefit scheme are being led by the Department of Transport.

Amendment Act 2005 expected to limit RAF liabilities

Social security and retirement reform

The retirement fund market

Figure 6.1 Retirement fund coverage, 2004/05



Source: Genesis Analytics, 2007

About half of the formally employed population has some form of retirement plan

South Africa's well-developed retirement fund market provides comparatively high coverage rates for middle- and high-income earners. A great many people, however, reach retirement age without adequate savings or income security. Figure 6.1 illustrates that in 2005, out of a total 16.8 million economically active South Africans, 12.3 million were employed and about 8 million had formal-sector occupations. Of those formally employed, an estimated 5.9 million, or about half the total employed population, were members of a provident or pension fund. Provident funds, which are allowed to pay benefits in lump-sum form, account for about 80 per cent of retirement fund membership.

Retirement fund reports and reporting requirements

Regulation and policy development in the social security and retirement funding environment rely on accurate and detailed information about the industry and associated trends. Steps are being taken to improve the quality and regularity of reporting by retirement funds and to consolidate data for analysis.

The current retirement fund market is highly fragmented. At the end of March 2007, the Financial Services Board (FSB) supervised 13 020 retirement funds, of which an estimated 4 000 are dormant. More than 80 per cent of these funds have less than 100 members. The audit exemption of these funds from reporting requirements has recently been removed, but most funds have yet to prepare their financial results in the required format. As of August 2007, only about 30 per cent of funds had submitted a report to the FSB.

In the 2006/07 reporting period, South African insurers collected premiums worth R111 billion from fund policies, which accounts for just over half of all long-term insurance premiums collected across all lines of business. In the same period, R120 billion was paid out in benefits from fund policies.

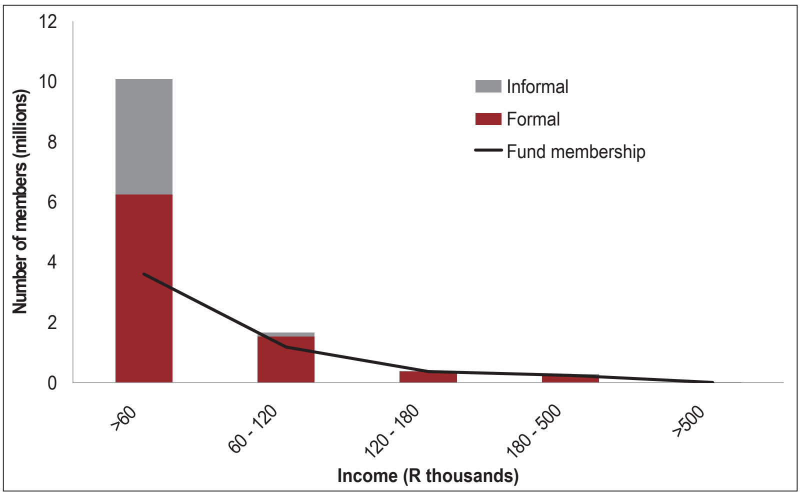
Gaps in retirement coverage are mainly below the R60 000 a year income level

Figure 6.2 shows fund membership among those in formal and informal employment according to annual income categories. Almost all individuals earning above R120 000 and employed in the formal sector are members of either a pension, provident or retirement annuity fund. However, gaps in coverage are evident in the below R60 000 income category. Roughly 2.7 million (42 per cent) of the formally employed in this income category do not have retirement coverage through a formal fund. About 360 000 formal employees are without retirement coverage in the R60 000 to R120 000 income category.

Reforms will take account of strengths and weakness in current system

In considering options for retirement industry reform, both the strengths and weaknesses of existing arrangements need to be taken into account. South Africa has a well-developed capital market and fund management industry, and established administration capacity, governed by a statutory framework that aims to achieve both effective competition and high standards of fund trusteeship and accountability. Although retirement arrangements are not mandatory, favourable tax treatment has contributed to high levels of coverage of middle- and high-income earners.

Figure 6.2 Retirement fund (pension and provident funds) coverage, 2005



Source: Genesis Analytics, 2007

The social security and retirement reform process

Social security systems can be organised in a wide variety of ways

Reforming the social security system is a complex process that will require a series of incremental changes. In broad terms, the organisation of social security can be consolidated and "scale-driven" – with a single operator of each of the core parts of the value chain – or the system can be "competition-driven", with multiple private-sector players. Many variations on these approaches are possible. Different countries adopt different ways of organising the five core activities – enrolment of members, collection of contributions, account administration, asset management and payment of benefits.

As noted above, initial steps in social security reform will include revision of the means tests applicable to social assistance grants, with a view to better alignment with the income tax threshold. Consideration also has to be given to the alignment and synchronisation of various components of the social assistance system and contributory social insurance arrangements.

A government task team is driving the reform process

The government task team driving the reform process includes representatives of the National Treasury, the Departments of Social Development, Labour, Health and Public Service and Administration, the Presidency, the South African Revenue Service, SASSA, the UIF and the Compensation Fund. It is supported by working groups and research projects on savings and risk-benefit design, institutional arrangements and systems, tax, and financial and actuarial modelling.

Much of the task team's work in 2007 involved developing a shared understanding of the institutional, design and implementation challenges ahead. An important step in the reform process has been to develop a better understanding of current retirement and risk-benefit arrangements. For this purpose, several research papers have investigated the structure, design and benefits coverage of various provident funds, bargaining council schemes, the Compensation Fund and other occupational benefit arrangements. The task team has also benefited from a range of interactions with the industry.

Actuarial and economic models are being used to estimate economic and social impacts of reforms

Understanding the likely costs and benefits of the reforms is crucial for understanding the impact of potential reform policies. The task team's work on contribution and benefit design options is supported by a substantial actuarial and economic modelling exercise, enabling plausible costs, financial sustainability and impact on income security to be tested over a 70-year time-scale. These models also estimate the effects of reform options on the possible evolution of income distribution, inequality and poverty in South Africa.

Efforts in 2008 will shift to more intensive engagement with the details of reform options, draft legislation, institutional reform and implementation challenges. A task team has been established by the National Economic Development and Labour Council (Nedlac) to facilitate formal consideration of reform proposals by government, business, labour and community representatives.

Basic social security benefit and design

Significant progress has been made in developing a common approach and options for the basic social security contribution and benefit design.

Low-income environment requires particular emphasis on administrative cost reduction

In a low-income environment, particular emphasis must be placed on reducing the administrative costs of the system, given that proportionally high administration costs can significantly reduce the amount of savings available at retirement. While there needs to be broad pooling of risk funds (unemployment, disability and survivors' benefits), there may be merit in opting out or exemption of accredited funds for the savings component. Further work and consultation in 2008 will focus on key reform issues, including:

- Qualifying ages for social security membership
- Coverage to the informally or irregularly employed, domestic and agricultural workers
- Qualifying earnings, and alignment with the definition of earnings for income tax purposes
- Annuity and lump sum payments

- The contribution rate and its division between a savings component, unemployment insurance, disability and survivor benefits and administration costs
- Options for conversion of savings into annuity income streams at retirement, and rules governing lump-sum payments
- Contribution ceilings for the basic social security arrangement
- Alignment and transition arrangements for existing funds, including both defined benefit and defined contribution schemes.

There is considerable scope for consolidation and improved coordination between existing statutory funds and their private sector counterparts, eliminating overlap in these funds.

Coordination between private and public sector funds to be explored

Modernisation of institutional design and governance

The task team has sought inputs on possible institutional governance arrangements for the social security system. A draft framework has been prepared, recommending separate but centralised institutions to deal with enrolment of members and communication with the public, maintenance of a central information registry, collection of contributions, and management and investment of funds.

Substantial benefits can be realised from systems integration and modernisation, including lower administration costs, improved public access and efficient account management.

More effective coordination between the various administrative role players needs to be prioritised if progress is to be made in shaping a common architecture and taking advantage of opportunities for systems integration. Focused attention on the opportunities for systems architecture integration and modernisation, led within government by SARS, SASSA and the UIF, will be a priority in 2008. Also under review is the role of the Guardian's Fund, administered by the Department of Justice and Constitutional Development, which holds funds on behalf of various persons, including orphans, persons incapable of managing their own affairs and unborn heirs.

Modernisation of systems requires both institutional coordination and substantial investment costs

Mandatory supplementary retirement funding

There have been several amendments to the Pensions Fund Act and the regulatory environment since the publication in 2004 of the first National Treasury discussion paper on retirement reform. The work of the task team in this area is focused on the regulatory changes that should accompany broader social security reform and a transition to mandatory retirement contributions, supplementary to the basic social security arrangement.

Task team focusing on regulatory changes and transition to mandatory contributions

There has also been progress in shaping regulatory reform proposals for supplementary retirement funding arrangements.

The envisaged framework recognises that the basic social security savings arrangement and mandatory contributions to accredited retirement funds should be complemented by voluntary investment and savings, and that as lifetime income rises individual choice should play a larger role in determining the preferred mix of savings arrangements.

Voluntary savings should complement mandatory retirement provision

There is considerable interest on the part of employers, unions and the financial sector in these reform proposals. Consultations and joint technical task team work will proceed during the course of 2008.

Social security, the wage subsidy proposal and tax treatment of retirement savings

More work has been done on the possible design of a wage subsidy

Further work has been done on the possible design of a wage subsidy, its impact on the labour market and income security, and its complementary role alongside the introduction of a mandatory social security contribution. This would assist in bringing low-income workers into the system, while contributing to employment creation through reducing labour costs to participating employers.

There is a key choice to be made between a general wage subsidy implemented through the PAYE system, and more targeted employment or wage subsidies.

Preliminary estimates suggest wage subsidy and social insurance would reduce number of people below poverty line by 20 per cent

An extensive modelling exercise has been undertaken to test the links between social security reform, employment, wage subsidy options, household income and poverty reduction. Preliminary projections suggest that a broad-based subsidy that partially offsets social security contributions for employees earning less than the personal income tax threshold would cost about R25 billion, and increase employment by about 350 000 in the first five-year period. The combined effect of the subsidy and social insurance would be an estimated 20 per cent reduction in head-count poverty over the same period.

Various other options have been proposed, including a wage subsidy targeted at first-time work seekers, in view of the severity of youth unemployment. These alternatives will be further investigated in 2008.

Revision of tax treatment of savings will accompany social security reform

Changes to the tax treatment of social security and retirement funding arrangements are under consideration, and will form an integral part of the overall social security and retirement reform framework. There is broad agreement that the present allowances for tax deduction of retirement contributions are in need of reform, with a view to reducing the tax advantage at higher incomes and contribution levels.

Conclusion

Constructive and challenging dialogue on reforms is anticipated over the year ahead

The basic social security arrangements under consideration and reform of the retirement funding environment are components of government's broader anti-poverty strategy and comprehensive social security programme. Social health insurance, reform of the RAF and reform of occupational health and safety and compensation benefits are also substantial and important reform challenges. A constructive and challenging dialogue between stakeholders on these and related reforms is anticipated over the year ahead, under the auspices of Nedlac and other consultative forums.