Setting the scene

What is the right social need

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Are we sure we're addressing the right social need?

At some level, long-term savings programmes and public policy around social protections are interlinked.

To begin with, we all agree that a healthy savings culture contributes to a country's economic growth in a number of ways.

LONG-TERM SAVINGS can:

- help fund development initiatives
- foster capital market formation and increase stock market liquidity and breadth
- encourage entrepreneurship
- reduce our dependency on foreign capital to fund our national debt.

There are important social and psychological benefits as well. Long-term savings help smooth consumption, ensuring that people are protected over different phases of their economic journey. By engendering a savings culture, a country can fortify its citizens against short-term economic shocks and, as such, reduce the cost of welfare provision for the state. Most importantly, it can build a level of financial empowerment and stability that has knock-on effects on health, both physical and mental, in individuals, families and communities. Each element of value helps reduce the burden that would fall on the government.

SOCIAL PROTECTIONS, however, represent a slightly different concept. Like social security, the focus here is on providing a financial floor or medical assistance to people who are at risk because of lack of income from unemployment, old age, poor health, limited capacity from childbirth or single parenthood.

If a country can successfully integrate longterm savings with social security, they can keep their citizens financially secure during good times and bad. This is in effect the imperative that has long kept pension funding at the top of the priority list as a long-term savings initiative in developed economies.

More importantly, if a country can tackle this challenge through a public–private partnership with its financial services industry, a massive burden on the state fiscus can be relieved. Here the solution is arrived at through the collective efforts of multiple agencies – not just the government – although the government will often play the role of overseer to ensure there's some link or integration.

A pension system primer

Case study/Lesson

As such, pension fund models globally have become almost inextricably entwined with the need to fund social protections for a population. International organisations such as the World Bank, the Organisation for Economic Co-operation and Development (OECD) and the International Labour Organization have tried to map out exactly how these essentially public-private partnerships can be integrated to address the numerous requirements for a given country. The multi-pillar pension framework that's set out on the next page is often applied to assess how comprehensive a social protection system needs to be. The more columns a country can fill on this scorecard the better. The model recognises that to cover all the requirements of a given population, different funding models or different agency partners may be required. This is where the interactions and interdependencies of that public-private partnership are best understood.

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A model for pension system excellence

The zero pillar is a government-funded social pension that ensures there is at least a minimum level of old-age income support, regardless of a person's employment history. For some countries, like South Africa, qualification is means tested. In other countries, this basic minimum is available to all. The distinguishing feature of this pillar is that funding is non-contributory. The government finances it, typically from tax revenues.

The first pillar is a compulsory contributory public pension where contributions are linked to earnings. It aims to replace a portion of pre-retirement income, typically on a pay-as-you-go basis (think a defined benefit type arrangement). Contributions of one generation fund the income requirements of the previous generation. As such, there are potential political and demographic risks. When South African policymakers originally conceptualised a national social security fund back in 2006/2007 this type of funding was envisaged. There would be contributory benefits for people earning above the old-age grant level.

The second pillar is a compulsory earnings-based scheme managed by the private sector. It's essentially an individual savings account although it can be structured in multiple ways. Second pillar funds employ a defined contribution-type framework wherein the investment and longevity risks sit squarely with the individual and the choices they make.

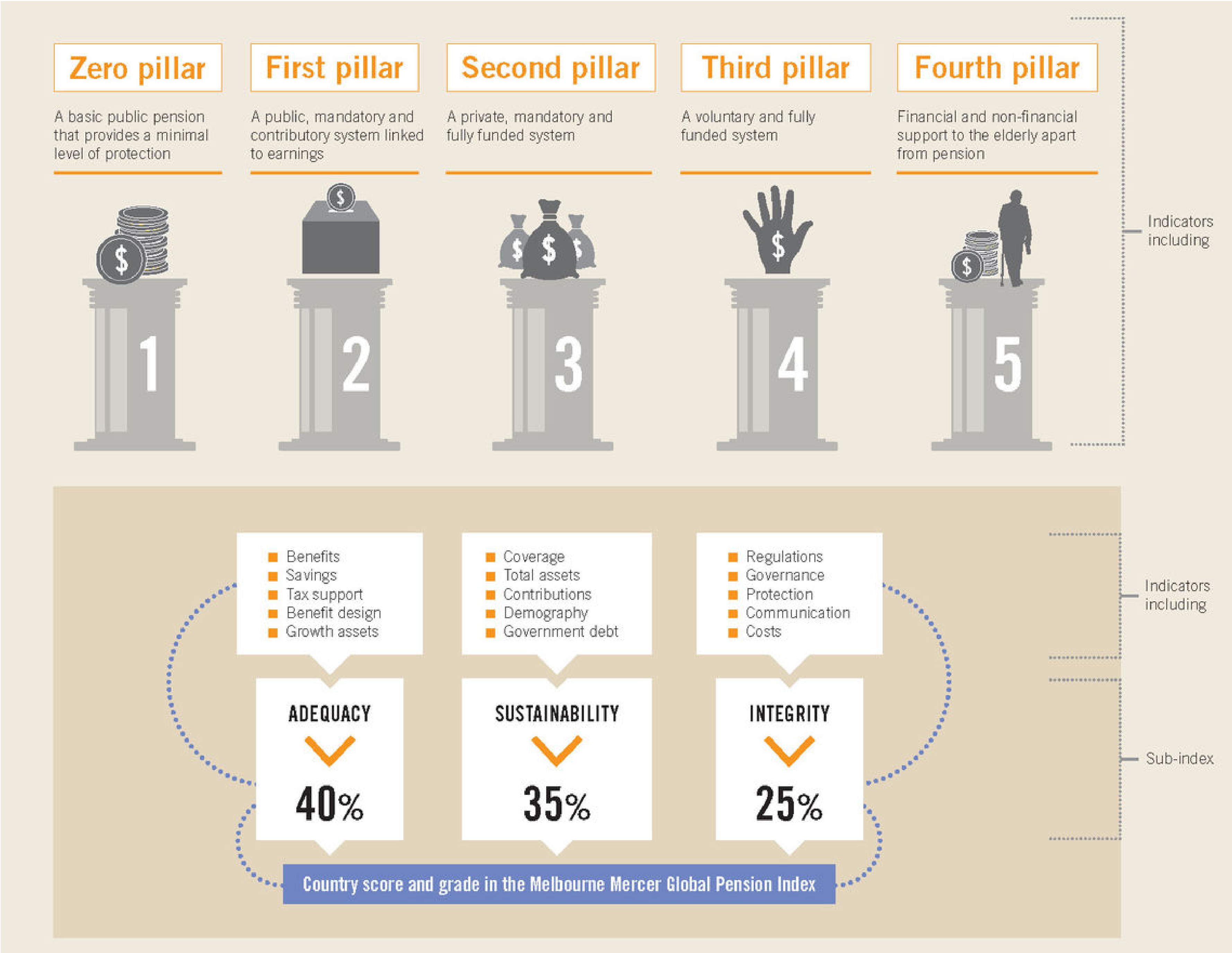
The third pillar represents the type of employer-based or occupational schemes that tend to dominate pension funding in South Africa. These are generally voluntary tax incentivised programmes that can provide either a defined benefit or defined contribution savings scheme and generally include risk benefits. Note the employer doesn't have to offer such a scheme in South Africa, but once on offer, all permanent employees must join it. This pillar can incorporate as much flexibility and discretion as an employer would like to include.

The fourth pillar is financial and nonfinancial support to the elderly apart from pensions. It provides either formal or informal support to facilitate social programmes such as healthcare or housing or asset accumulation (whether financial or non-financial[1]).

> **South Africa has a fairly minimal version of the zero pillar with its various grant programmes such as the old person's grant and the Unemployment Insurance Fund. But it also has a surprisingly robust and mature third pillar solution.**

The Melbourne Mercer Global Pension Index

The Melbourne Mercer Global Pension Index takes this exercise one step further. It rates each country's social protection system by evaluating the extent to which a country provides cover across these multiple pillars. Their final score assesses the adequacy, sustainability and integrity of the cover given the country's economic, social, cultural, political and historical context[2].



How does South Africa stack up against such criteria? South Africa has a fairly minimal version of the zero pillar with its various grant programmes such as the old person's grant and the Unemployment Insurance Fund (UIF). But it also has a surprisingly robust and mature third pillar solution. This means the private sector carries the bulk of the responsibility for providing protections beyond the most minimal. For the most part, these protections only apply to people who are employed.

Note that only one or two countries in Africa (Mauritius being an important exception) have all five pillars in place.

This lack of inclusiveness earns South Africa a C score in the Melbourne Mercer Global Pension Index[3]. This means the system "has some good features but also has some major risks and/or shortcomings that should be addressed. Without these improvements its efficacy and/or long-term sustainability can be questioned."

As noted in the report: "Although it has some admirable features, it is not deemed to be a sustainable or comprehensive solution." More troubling is that this score appears to be slipping as the reform process gets more muddied[4]. The report offers no further comment.

Consider, for example, the fact that we currently provide a highly evolved solution for retirement savings but there has been little progress made on creating a comprehensive social security system to address the needs of all South Africans. It is this aspect of our system that has most likely contributed to our score of C, in spite of the sophistication of our pension fund industry and the strong scores it receives for governance and integrity in the index.

In our next chapter, we address the question of coverage adequacy with our current government-provided social protections. More importantly, we try to illustrate just how much value our current system actually adds to both the government, in alleviating demands on the fiscus, and to employers, in enhancing employee attraction and retention. But the question we will repeatedly raise in this edition of Benefits Barometer is: **Is this enough and could we not do more?**

We agree wholeheartedly that long-term savings and social protections can be most effective when they are interlinked. We also believe that in a developing economy, a public-private partnership is most cost-effective in providing such a solution. The point we will challenge is whether placing retirement savings at the top of the list for a long-term savings drive serves the broader challenges of a **developing** economy best.

This question is particularly pertinent when that developing economy is South Africa, with its unique historical, political and social features. It means our employers and policymakers alike have very different challenges beyond retirement savings that urgently demand our attention. For employers and the country, these challenges are about financial stability, financial capability and a financial security that transcends more than just the retirement years.

> **A lack of inclusiveness earns South Africa a C score in the Melbourne Mercer Global Pension Index. "Although it has some admirable features, it is not deemed to be a sustainable or comprehensive solution."**

For broader South Africans, the immediate challenge is how to better address the issue of social mobility. By social mobility we mean the ability of an individual or their family to employ occupation, education, wealth or some other similar indicator of achievement to change their perceived status in the community or economy. With this in mind, we would like to propose that there is a shift in thinking about compulsory savings: what's needed at this point in our evolution as an economy is a compulsory savings programme that promotes:

- **asset acquisition** to a population that has been denied such access for four generations
- **education,** in a country where only 50 public schools out of several thousand are sufficiently equipped to provide transformational education[5]
- **health,** in an environment where government-funded universal health may only be feasible in 15 to 20 years
- **risk protections** against loss of income to one's family – in the event of death, disability and, yes, even retirement.

Concluding thoughts

Let's get to that discussion though, after we've had a chance to thoroughly examine the value of what's already in place – both in terms of the social protections offered by the public sector and contributions from the private sector. At issue is not just what each sector is currently providing but who is best placed to provide South Africa with what it needs going forward. This is not a contest. It's a recognition that as a country, our servicing needs will have to evolve as needs and agencies evolve.

References

1 World Bank Pension Reform Primer, 2008

2 Melbourne Mercer Global Pension Index, 2015

3 Melbourne Mercer Global Pension Index, 2015

4 Ibid

5 Spaull and Kotze, 2015