Setting the scene

What is the value of employee benefits

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Why Should we care?

Each preceding edition of *Benefits Barometer* has argued the same point: that employee benefits are important. We've framed our arguments from any number of different perspectives though. Benefits Barometer 2013: 'The employee benefits system and its inter-dependencies' tried to map out the interconnections between the various stakeholders of the government, employer, union and household in terms of how these four entities come together to tackle the significant task of managing the physical, mental and financial well-being of an individual. Our focus in that edition here was primarily on the tenuous and fragmented nature of these connections and how this created sub-optimal outcomes.

In 2014, Benefits Barometer 2014: 'Why it matters?' examined the role that employee benefits play in providing, on behalf of the government, those 'minimum floor' and 'rising floor' social protections to one important segment of the economy, the employed. As employee benefits are often the only form of financial savings or safety net for many South Africans, getting it right isn't just about being nice to employees, it's about safeguarding the future of our society.

In 2015, our focus shifted to the employee specifically. Sadly, we realised that collectively we were losing the war on getting both employees and employers to care enough. We thought we appreciated why this was the case. We argued that the value of these employee benefits would never be properly assessed or appreciated by the individual until we helped them address their more immediate needs of day-to-day financial survival – their holistic financial well-being mattered.

What this chapter tries to add to the debate is a perspective on the true economic value of these benefits to the various stakeholders: the government, the employer and the individual. In essence, we recognise here that we need to provide a bit more financial substance to the argument: 'Employee benefits are important!'

Another way we could ask the question is:

- *What if employee benefits didn't exist?*
  - *What would be the cost to government?*
  - *And what would be the cost to individual?*
  - *What would be the cost to the employer?*

> **As employee benefits are often the only form of financial savings or safety net for many South Africans, getting it right isn't just about being nice to employees, it's about safeguarding the future of our society.**

What if the government was our sole provider of employee benefits?

Exactly what do we include when we consider the ambit of social protections? Conventionally these inter-related protections cover income protections for individuals and their families in the event of retirement, loss of employment, loss of income from becoming disabled, and loss of life, as well as healthcare benefits and initiatives to enhance financial capability.

In many ways, it's in our interests to have the government play a role here. When there are issues of redistribution, government is clearly in the best position to oversee this exercise. Where there are circumstances when the market size exceeds the capacity or appetite of the private sector (such as in providing unemployment benefits), the government must fill that gap.

In theory, a government could provide its citizens with many or all of these protections. As we saw in earlier chapters, governments around the world have implemented various models, ranging from totally centralised, government-controlled arrangements to totally decentralised, privatised arrangements, and any combination in between.

As it currently stands, though, the South African government provides an array of means-tested social grants that primarily target the lowest income groups. Unfortunately, the current raft of legislated benefits are not ideal on their own.

Older person's grants (OPG) and disability grants are two of the more critical tools the government employs for protecting low-income workers when retirement savings or disability income replacement policies would be beyond their reach[1].

The Compensation for Occupational Injuries and Diseases Fund (COID) and the Occupational Diseases in Mines and Works Act (ODIMWA), for example, provide employees with an option to claim for loss of income due to injury or disease suffered on the job. Additional government-driven benefits include the Unemployment Insurance Fund (UIF) which provides short-term benefits to cover unemployment, absence due to illness, maternity leave, and even, in some cases, to assist families in the event of death. And finally there's the Road Accident Fund, which applies to injuries in motor vehicle accidents exclusively.

But a government could provide its citizens with many or all of these protections

Above and beyond that, the government employs tax incentives and oversight bodies to create an array of supplementary protections (disability and death cover, medical schemes, spousal and family protections, income savings for retirement) that are outsourced to the private sector.

As things currently stand, there are significant overlaps and gaps between the offerings of these various programmes, both within public sector offerings and between the public and private sector. Processing of claims frequently demands applications to multiple agencies. As such, it's likely that considerable efficiencies and cost savings could be gained from restructuring and consolidation. To do so, though, would no doubt require considerable political will from a number of different agencies in the process.

The reality is, not only are these state benefits mostly capped, but generally benefits are at an unsustainable level for many families. Consider the employer who says that they were simply not interested in providing their employees with an employee benefit package. How viable would these existing protections be as fall-back solutions?

Government grant or assistance	Who qualifies	What's granted	For what timeframe	How it is funded
Older person's grant War veteran's grant Disability grant	Any citizen over pension age, means-tested	Up to R1 500 a month for someone with income less than R2 250 a month, and assets less than R990 000	Until death, while qualifying under means test	Tax revenues
Child support grant	Primary caregiver of child below age 18, means-tested	Up to R350 a month for caregiver with assets less than R42 000	Until child reaches age 18	Tax revenues
Care support grant	Primary caregiver of child with severe disability, means-tested	Up to R1 500 a month for caregiver with assets less than R180 000	Until child reaches age 18	Tax revenues
Compensation for Occupational Injuries and Diseases Fund	Both casual and temporary workers who experience loss of income due to job-related injury, disease or death	**Temporary disability** (not deemed permanent and reviewed after a year): Totally unable to work: receive 75% of normal wage they would have earned over disability period Partially able to work: COID Fund tops up 75% of the **difference** between the partial wages received and what would have been the full wage had injury not occurred **Permanent disability:** Disability rated between 1% and 100% depending on severity of disability Disability less than 30%: Cash lump sum determined by fund Disability between 30% and 100%: Monthly pension amount determined by fund Disability = 100% 75% of wages	Temporary disability: Payment of period of disability up to 1 year, then review Permanent disability: Until death	Employer contributions using Department of Labour assessment formula: (Total worker's pay/100) × tariff based on risks associated with job

Unemployment Insurance Fund	Contributing workers who are unemployed or unable to work as a result of illness, maternity or adoption leave	Low-paid workers get paid up to 58% of their normal income, with higher paid workers earning a lower percentage The cap is for workers earning R12 478 a month or more, who get 38% of this amount	Worker gets one day's credit for every six calendar days they have been employed, up to 34 weeks (238 days) Unemployment, adoption or dependant benefits: up to 238 days earned Maternity benefits can be paid up to 121 days (17.32 weeks) earned	Employee and employer contributions = 2% of pay to a limit
Road Accident Fund	Any person injured, and dependants of anyone killed in a road accident, except for the driver who caused the accident	Amount determined by the fund. Average value of a claim in 2015 was R114 969[2]		Fuel levies

What would an individual get from government?

What's clear is that what individuals and their families could currently get in the way of social protections would be minimal at best. Despite the large portion of national budget dedicated to social protection (about 13% of allocated government expenditure), the government is still not able to satisfy fully the need for this type of protection.

To illustrate this, let's assume that getting an adequate payout means getting near 100% of the gross income you were earning while you were working (this may sound high, but for lower income workers it's probably the reality of need). That would mean that the old person's grant of R1 505 per month (to be increased to R1 510 in October 2016) would only be adequate for:

- individuals who have never worked or earned an income
- the lowest earning 50% of unskilled workers
- roughly the lowest 25% of semi-skilled workers.

This estimation is based on the monthly earnings data reported in the Labour Market Dynamics in South Africa 2014 report by Statistics South Africa. This report estimates that the lowest earning 50% of unskilled workers were earning about R1 800 per month.

Similarly, the COID Fund pays only about 75% of wages for the time an individual is booked off for temporary disability. The UIF, which is generally limited to formal sector workers, excludes other workers such as household, casual and temporary workers. And its benefits (and contributions) are capped to certain levels, which are considered quite low. Additionally, the fund does not cover employees if they become unemployed because they failed to report to work at required times and dates, or they quit. This fails to recognise that there are numerous reasons that force an individual to leave a job. This includes instances where an individual resigns to take care of a sick family member, a time when they are likely to most need UIF support.

The 2016 Budget Review notes that the draft Unemployment Insurance Bill proposes to improve maternity, illness and death benefits for eligible contributors[3]. This is certainly a step forward but hardly provides much more than a stop-gap solution. Effectively, even if this benefit were accessible to all, there would be a need to top it up to an adequate level for many workers.

Overall, government's social security funds may currently be in a commendable financial position (the Road Accident Fund being the exception), but a range of challenges such as internal systems, governance issues and rising unemployment raise a few flags.

By contrast, government assistance programmes funded out of tax money, such as the social grants, are in a worse-off position because of the problems facing the fiscus – notably the stubbornly low growth rate. It seems unlikely that the situation will improve. Research by economists Rossouw, Joubert and Breytenbach indicated that if the spending trends from 2012/2013 were to continue unabated, South Africa would reach a fiscal cliff by 2026. A government fiscal cliff is a situation where government expenditure becomes too large to sustain and therefore threatens sudden or severe economic decline. It's likely that the extension of social protection and the increasing cost of living will only serve to make public financing more unsustainable than it appears to be currently[4].

So let's get to a more relevant question: **Should we even be asking the government to provide anything more than the most basic of protections given the current demands on the fiscus, the administrative skills of government agencies, and the current concerns around 'state capture'?**

And does the government not have more important work to do creating jobs and generating economic growth so that South Africa can deal with poverty, inequality and unemployment as envisaged in the formerly adopted National Development Plan?

Regardless of who provides the benefits, three important questions remain:

1. Do individuals actually need the benefits and do they know they need them?

2 Given free rein, would individuals actually buy them? Or would behavioural aspects derail the process?
3 Can they buy it? Would they be able to access the benefits at all, or at a reasonable price?

Passing the mantle to employers

As our system evolved, it simply made sense for the government to outsource some elements of the value chain. By global standards, South African employers have been particularly attentive in coming to the fore and providing these essential benefits. In *Benefits Barometer 2015: 'What role'* we highlighted that what employers actually do is provide a 'rising floor' of protection to employees in contrast to the 'minimum floor' provided by the government. This makes government responsible for making sure that everyone has the very basic standard of living. Beyond that, the very fact that an individual is employed starts to elevate them to another class. Typically, individuals in formal employment have higher standards of living, which employers protect through the employee benefits structure, providing a 'rising floor' that corresponds with the individual's unique circumstances, their standard of living and the particular risks they may face.

But what if business pressures make employers more circumspect about making these benefits available? Here we think it would be useful for employers to consider that choice from three distinctly different perspectives. **In the first case below, we can consider employee benefits from the conventional view: their impact on productivity and talent management. Secondly, we can examine the economic contribution of employee benefits to the broader economy. Last, but certainly most importantly, we can examine whether, in absence of employer-sponsored or government-provided safety nets, it would be economically viable for an individual to source an adequate level of protections on their own – as a retail consumer.**

CASE 1. Corporates offering benefits to employees

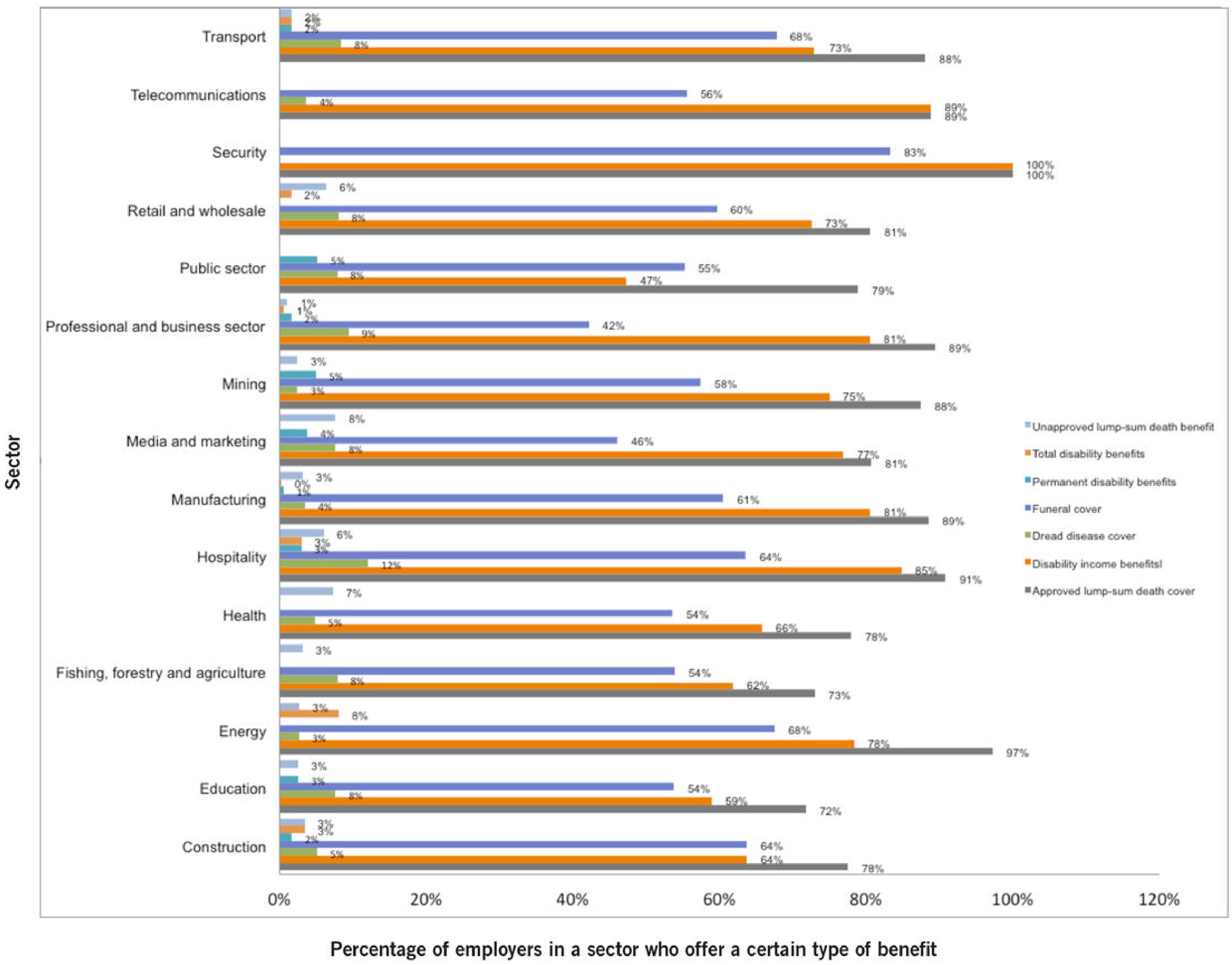
Traditionally, the case for employers to provide employee benefits is presented from the perspective of their business value: they increase employee productivity, reduce employee turnover[5] and absenteeism and ensure higher job satisfaction and motivation[6]. In theory, an attractive benefits package helps to create an image of 'a preferred employer' when the market for talent becomes highly competitive.

Intriguingly, while South African employers are attentive to making sure a minimum level of benefits is available, they probably haven't capitalised as much as American companies might have in making benefit packages a particular drawcard for talent.

Figure 1 summarises the most common benefits offered by employers in various industries.

> **What employers actually do is provide a 'rising floor' of protection to employees in contrast to the 'minimum floor' provided by the government.**

Figure 1: Risk benefits offered in each sector[7]



Source: Alexander Forbes Financial Services, 2015

Figure 1 demonstrates the variety of cover that employers tend to provide. Various industries provide different benefits according to the specific needs of workers in that industry, but given how dramatically different these industries are, what is perhaps more surprising is that there isn't more variation.

But employers derive other ancillary values from providing employee benefits. Traditionally employee benefits were considered a form of management tool. Employers could structure benefits in such a way that they not only could attract the right sort of employee into their companies (those who placed a high premium on financial prudence) – but they could also make sure these employees exited employment at a time that worked best for the employer[8].

Ultimately, the tax treatment of employee benefits also works to the advantage of all stakeholders. In the absence of the tax incentives, either the cost of these benefits would be shifted to the employee in the form of lower wages, or customers would have to absorb them in the form of higher prices or fees (to enable higher wages to be paid given a return on capital) or the providers of capital would have to accept lower returns. Either way there are consequences for the economy at large.

CASE 2. The economic value of employersponsored benefits

Placing a monetary value on employersponsored benefits is quite difficult, especially given that there are also substantial non-monetary benefits. Employee benefits are protections against the risk of potential future events that could negatively affect employees' financial well-being. As these events are entirely uncertain, assigning a specific, concrete value to them is seemingly impossible. This is further complicated by the fact that the value of these protections to a specific individual is subjective and differs according to their preferences. Economists have attempted to work around this.

The simplest approach to take is to say that it's the cost of providing a benefit or the total amount in premiums paid to secure the benefits that determines how valuable that benefit is. Using this approach, a study by True South Actuaries and Consultants is quite illustrative. The study reported that of the 13 million earners in South Africa at the time, 130 050 were expected to die each year, while 43 065 were expected to experience a disabling event[9]. Therefore, using the premium approach described above, the study found that existing group risk products translate into savings to the government and indirectly to taxpayers to a total of R2.619 billion for death cover and R4.660 billion for disability cover[10].

Recently, though, a study entitled *Financial security for working Americans: An economic analysis of insurance products in workplace benefits programs* broke new ground by providing a far more rigorous way of assessing this value. Their analysis takes into account consumer choice in the face of uncertainty, employer responses to tax and labour market conditions and the provisions of government public assistance programmes. Using this approach, they determined, for example, that in the United States, employees value each dollar of disability cover at 20 to 60 times its cost in premiums. Life insurance, in turn, was valued at 60 to 170 times its premium value. And this was based on a prospective view of the benefit. If the benefit was triggered, the actual value was even higher[11].

In their assessment, the main reason employees derive economic value from employee benefits is the fact that most individuals are quite averse to uncertainty, and so any mechanism that reduces this (such as insurance) will be valuable to them. The authors factored in how much the government provides for social security insurance and the tax advantages that employer-sponsored benefits enjoy, and made assumptions about individuals' risk aversion – a measure of how much people are willing to pay to be protected from an unfortunate circumstance such as disability.

All told, the study concluded that there was a welfare value of employer-sponsored group disability insurance that ranged from $230 billion to $590 billion per year on a population of 40 million employees. Similarly, employer-sponsored group life provided an economic value of $1.25 trillion to $3.5 trillion annually to the approximately 105 million people covered[12].

But the study also detailed the contributions these protections made to society at large by reducing the call on public assistance resources. They calculated that reduction in burden to be close to $2.25 billion to $4.5 billion a year. They further cited the impact on the overall standard of living that was another consequence of these employer-sponsored benefits.

Our point in describing these findings in detail is simply to highlight that if we were able to perform a similarly rigorous analysis of the true economic value of these employer-sponsored benefits in South Africa, employers and employees might formulate a deeper appreciation for the role they play. Unfortunately, estimating these values for South Africa is made difficult by the fact that we lack full information about individuals' levels of risk aversion and other technical, mathematical components required to make estimations in the South African context. However, an important point is that the estimates of the economic value of employer-sponsored insurance for the United States are that high, despite an extensive social security system in that country, illustrating that employer-sponsored benefits are a crucial complement to government-provided benefits.

CASE 3. How well could individuals source these protections on their own?

The answer to this question is: it depends.

It firstly depends on whether they know they need the benefit in the first place. So some form of advice or recommendation, or compulsion may be required.

Secondly, it depends on whether they will actually do anything about it. Apathy and other behavioural factors can play a role.

Finally, if they know they need it, and want to do something about it, can they do so in their individual capacity? For example, a terminally ill patient may require life cover but could struggle to access life cover as an individual, without the benefit of a group scheme with underwriting limits.

Let's consider the following worked examples:

TABLE 1

Admin			How much more expensive would 'going it alone' be by getting an individual retail product?			
			25 years	35 years	45 years	55 years
Annual salary	**Sum assured**	**Benefit**				
72 000	216 000	Life cover	49%	69%	137%	327%
144 000	432 000	Life cover	-15%	2%	66%	232%
72 000	216 000	Lump-sum disability	65%	99%	166%	265%
144 000	432 000	Lump-sum disability	-5%	16%	83%	191%
72 000	20 000	Funeral	663%	663%	663%	663%
144 000	20 000	Funeral	663%	663%	663%	663%

TABLE 2

Manufacturing						
			25 years	35 years	45 years	55 years
Annual salary	**Sum assured**	**Benefit**				
72 000	216 000	Life cover	23%	39%	94%	250%
144 000	432 000	Life cover	-30%	-17%	36%	172%
72 000	216 000	Lump-sum disability	122%	177%	370%	716%
144 000	432 000	Lump-sum disability	61%	114%	308%	640%
72 000	20 000	Funeral	568%	568%	568%	568%
144 000	20 000	Funeral	568%	568%	568%	568%

Note: This is Alexander Forbes Life data. However, because Alexander Forbes does not offer a stepped premium pattern for 25-year-olds, the premiums in the table are for illustrative purposes only.

In the worked example, we contrast the range of premiums a particular individual might pay if they purchased these protections themselves against what they would pay as a member of a group scheme. We've used two examples: an employee in the business services sector, and an employee in the manufacturing sector, to capture both whitecollar and blue-collar workers. In both cases, the employee is a male non-smoker with a Grade 12 qualification.

The example shows how premiums might change for the different risk products of life cover, disability cover or funeral cover as both the individual's age and salary increase. Note how these changes impact on the product costs bought as an individual, but they remain the same inside a group scheme, irrespective of pay or age.

The final sub-table in each section shows the extent to which 'going it alone' would be relatively more expensive, by showing the percentage by which retail premiums are higher than employer group schemes at different life stages and income levels.

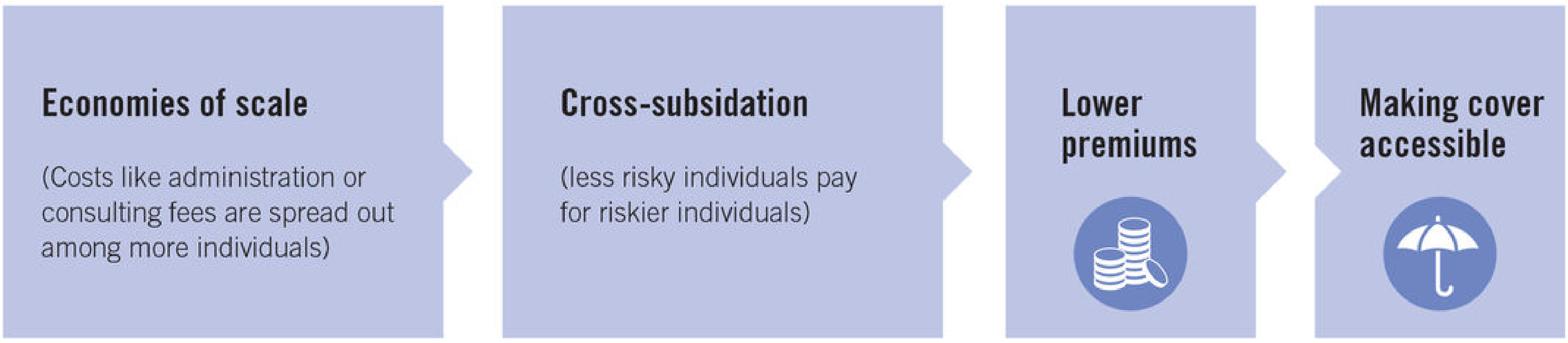
Several points become clear here. At different ages, there's a differential experience with group schemes. For the young new entrant, it's typically cheaper to seek out a retail product than pay a group scheme premium (as the negative values show), so there's the tantalising prospect that they could get better costs on their own. But that situation begins to change dramatically once factors like age, marriage and children and other dependants come into the question.

An exception here would be retirement savings. Irrespective of age, individuals should generally be able to get lower investment (and administration) costs in a group scheme when compared to a retail investment product.

The issue an employer needs to grapple with is, if left to their own devices, how likely would it be that that individual purchases such protections? Once an individual has ducked these costs, how likely would they be to reconsider these financial protections at a later date when they would most definitely need them most? The fundamental point here is that it's really in no one's interest, long term, to have an employee without some level of financial or medical protection.

Addressing this question of cost and benefit requires a deeper appreciation of the economics of employer-sponsored arrangements. Other than often more affordable premiums in group arrangements, being part of employer-sponsored arrangements also means avoiding the underwriting process, which can otherwise result in higher premiums and endorsements. The underwriting process involves assessing the lifestyle and health risks of a particular individual, where a person with higher risks (unhealthier lifestyle, genetic conditions) would have to pay a higher premium.

Therefore, the advantage of employee benefi ts being structured as group arrangements are as follows:



The favourable tax arrangements that go hand in hand with some employee benefi ts also generate some value for employees. This really depends on the employee's particular salary level and benefi t level. Those who are higher up on the earnings scale are less likely to benefi t because of the escalation of the tax system, and those who are at the very bottom are unaffected by tax, and so do not benefi t from tax incentives. Nevertheless, at least the proportion of employees in the middle of the earnings scale do benefi t economically from these arrangements.

How do we see the way forward?

There's good reason to believe that in the future employee benefi ts as we have outlined here will be a thing of the past. Already we are moving to the point where we can offer group rates and group pricing without an individual necessarily being attached to a specifi c employer. From the perspective of the employer, this may not be entirely desirable.

Put it all together and what have you got?

The employee benefits system from a numbers perspective

Concluding thoughts

Employer-sponsored benefits help protect employees' minimum standard of living, especially by complementing the inadequate protections that the government currently provides. Although quantifying the value of employersponsored benefits is tricky, there is reason to believe that the economic value added to employees, employers and the country exceeds the mere cost borne by employers in providing them. Employees gain from cost advantages arising from economies of scale. Employers gain from the stabilising influence these protections have on their workforce. And the South African economy gains from the amount of stable, long-term savings injected into the economy.

What we haven't completely addressed here is the extent of the overlaps and gaps between the two systems. Work on this is currently under way from various quarters, but this will provide the ultimate 'glue' that's currently missing from our social protections.

But we do not believe that one has to wait for a utopian outcome before meaningful change can be effected. In Part 2: **'Fleshing out the vision a better model'** we outline a programme that we feel allows us to fill in some other critical elements that constitute both the social protection and the social mobility aspects that our system needs to provide. In this idealised model we see important but clearly distinctive roles for both the public and private sectors.

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