# Summary

# Comprehensive Social Security in South Africa

Discussion paper by

The Inter-Departmental Task Team on Social Security and Retirement Reform (IDTT) - November 2016

**Prepared by:**
Kobus Hanekom
Head: Strategy, Governance & Compliance
**t.** +27 (0) 21 912 3311
**e.** kobus@simekaconsult.co.za

# CONTENTS



**Editorial note:**

In this summary, we focused on the aspects that are of particular importance to retirement fund stakeholders.

We provide an overview and high level comment in paragraph 1.

In the rest of the document we provide a summary of the proposals using relevant extracts from the discussion paper with minor adjustments and added emphasis.

## 1. Overview

A year ago the union movement called for the T-Day legislation to be scrapped or postponed. As a result the measures requiring compulsory annuitisation for provident fund members was postponed to 1 March 2018 to give the parties more time to consult. The consultation process has been slow and we understand that little progress has been made to date. One of the demands made by the union movement is that the T-Day measures can only be considered in the context of holistic social security reform.

On 18 November 2016 the long awaited discussion paper was released for comment. On closer scrutiny it appears that the report circulated is version 11.9 of March 2012. Commentators report that a subsequent paper produced in 2015, which contained more of a National Treasury influence did not find favour. The fact that Government has taken so long to agree on the paper is indicative of the tensions and disagreement on the appropriate way forward.

The central reform proposal is the introduction of a National Social Security Fund (NSSF), 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, inclusive of a 2% UIF contribution, of qualifying earnings up to a ceiling that will be aligned with the UIF earnings threshold. The dated report puts the number at R149 736 pa. This ceiling has increased to R178 464 in 2015.

That will require that the first twelve percent of all workers' retirement contributions on earnings up to the NSSF ceiling [R178 464] will go to the NSSF rather than to their present retirement funds. As a result, all these funds will suffer a significant loss of business. In addition, they will henceforth be competing for supplementary savings over and above workers' contributions to the NSSF. 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 for higher-income earners.

This paper is published for public comment. Government undertakes to engage stakeholders in an intensive consultation process to ensure that the 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 Inter-Departmental Task Team on Social Security and Retirement Reform (IDTT) will coordinate a series of consultative forums to ensure that the views of retirement fund members, organised labour, business and community groups are heard.

The implementation strategy will be sequenced in three broad phases. This includes the creation of a unified policy platform under a new department, the establishment of the NSSF and institutional consolidation, and then a five-to-ten-year transition from implementation of the NSSF and the alignment of existing retirement funds with the NSSF.

The publication of this paper is a watershed moment for the South African Retirement Fund Industry. It will intensify the retirement reform debate and help shape the future of the industry. What we all want is an efficient and cost effective system that will benefit our members and ensure good outcomes.

The intention is to provide all fellow South Africans with the dignity offered by a holistic social security support framework. The solutions proposed could contribute to the desired outcome. Proposals such as the NSSF are so significant in sheer size and will have such a significant impact on the industry that we have to make sure that they are indeed the most appropriate and compelling solutions for our country. Solutions that look good on paper and that works well in other parts of the world may not necessarily work well in South Africa. Putting almost the entire country's savings in one pot comes with certain systemic risks including a requirement of trust by the working population that the Funds will be appropriately invested even if the proposal shift a significant part of the investment risk centrally to government.

We will consider and research these proposals and will work with our clients and industry organisations to help develop and refine them or where appropriate, to put forward other solutions that are more practical and sustainable.

## 2. Social security reform: background

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, version 11.9 of March 2012, summarises the IDTT's findings and offers extensive proposals for reforming and improving social security delivery.

## 3. The key reform proposals

Seven social security reform initiatives are proposed:

### 3.1 Establishment of a national 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 [inclusive of a 2% UIF contribution] of qualifying earnings up to a ceiling that will be aligned with the UIF earnings threshold (the 2012 report states the amount as R149 736 per year, but the current ceiling is R 178 464).

*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.

*Employees earning below an agreed threshold (R13 000 per year) need not contribute to the NSSF* but will continue to contribute to the UIF.

***Observation****: It is clear that this report was written before the proposals for a minimum wage of R3 500 per month or R42 000 per year. The modelling on which these proposals were based may therefore not be valid anymore as a significant government subsidy is required up to this amount.*

*For self-employed individuals* a simplified contribution arrangement 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 [disability income] benefits for all workers and their families in combination with revised social assistance entitlements.

### 3.2 Expanding social assistance: Means test to be phased out

The means tests for social old age grants will 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.

### 3.3 Enhancing / consolidating social insurance funds

A consolidated department will bring coherence to policy. It 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.

Improved coordination in administration and infrastructure will reduce system costs and the potential for fraud, especially multiple claims by the same person on different funds.

### 3.4 Regulatory reform of the pensions and life insurance industry

Workers earning above the tax threshold will be encouraged to contribute to a supplementary pension fund in addition to their NSSF contributions to ensure adequate provision.

*Auto enrolment:* A default rule is proposed, under which employers will be obliged to enrol employees in a supplementary 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.

Substantial improvements to the regulation of the retirement industry is proposed.

### 3.5 Strengthen the links between social security and labour

The reforms will enhance the links between social security and employment and ensure closer policy coordination between the consolidated department of social security and the Department of Labour.

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.

### 3.6 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 proposes that credits be accrued at a rate of one day for every four days worked (up from one day for every six worked) and the long-term unemployed will receive a continuation benefit.

### 3.7 Alignment of social security with National Health Insurance

The National Health Insurance proposals were published in August 2011 and are presently undergoing a process of public consultation. These reforms will be phased in over a 14-year timeframe.

## 4. Comprehensive social security system

The intention of these reforms is to establish a comprehensive system of social security in South Africa. 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.

***Figure 1 – A new system of social security***

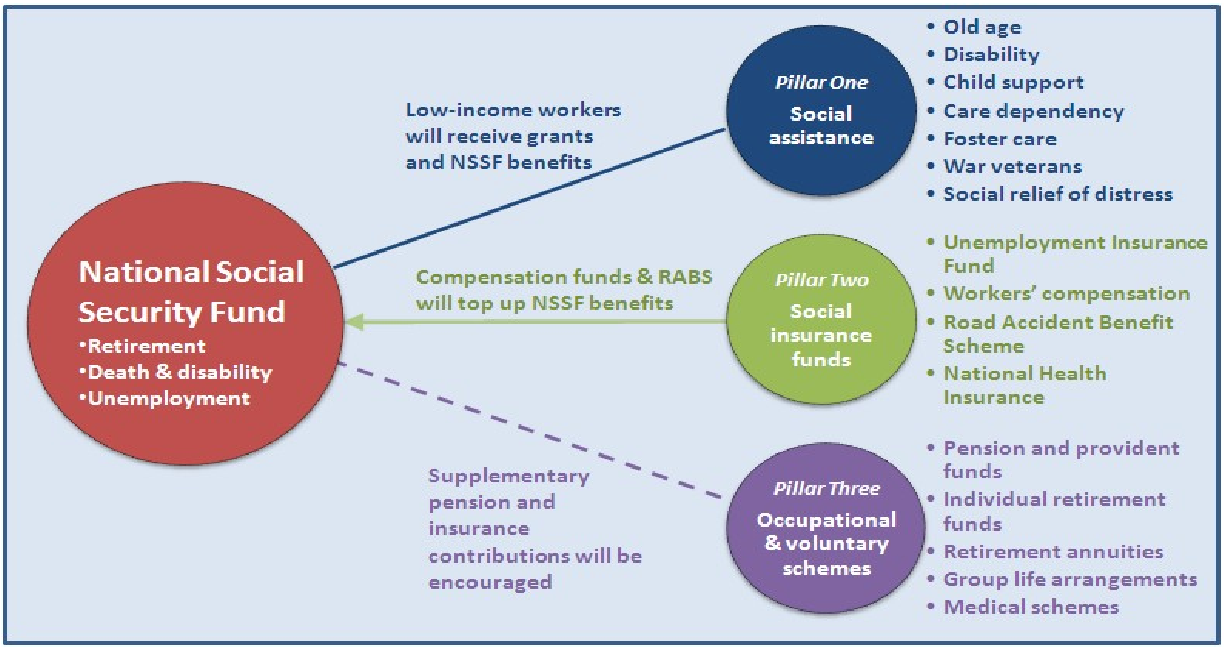



Figure 1 shows how the different social security entities will be aligned. The NSSF will fulfil the role of a second pillar, and will subsume some of the responsibilities of existing social insurance funds. Under the comprehensive system, non-contributory social assistance will remain a key intervention for the most vulnerable members of society.

### Institutional arrangements, regulation and consumer protection

Eight institutional initiatives are proposed that will underpin a comprehensive system of social security:

1. **Collection of contributions**: Will be undertaken by the South African Revenue Service (SARS).
2. **Administration**: The registration of contributors and administration of accounts will be undertaken by a proposed new master registry.
3. **Client interface**: Effective communication will require both systems and service delivery improvements, across the existing social security entities.
4. **Payment of benefits**: Modernisation and integration of payment arrangements offers considerable scope for cost-saving.

5. **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.
6. **Appeals adjudication**: Dedicated and independent capacity will be established to arbitrate and resolve disputes.
7. **Regulation and oversight**: Regulatory oversight will be strengthened and approved supplementary funds subjected to a higher standard of reporting and fiduciary responsibility to protect the interests of members.
8. **Public sector funds**: The new framework will include public sector funds.

## 5. Impact of the NSSF on existing contributory funds

Introduction of the NSSF will have a significant impact on existing retirement and insurance arrangements.

### Occupational and voluntary funds

The first ten per cent of all workers' retirement contributions on earnings up to the NSSF ceiling [R178 464] 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.

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.

A significant proportion of bargaining council employees 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.

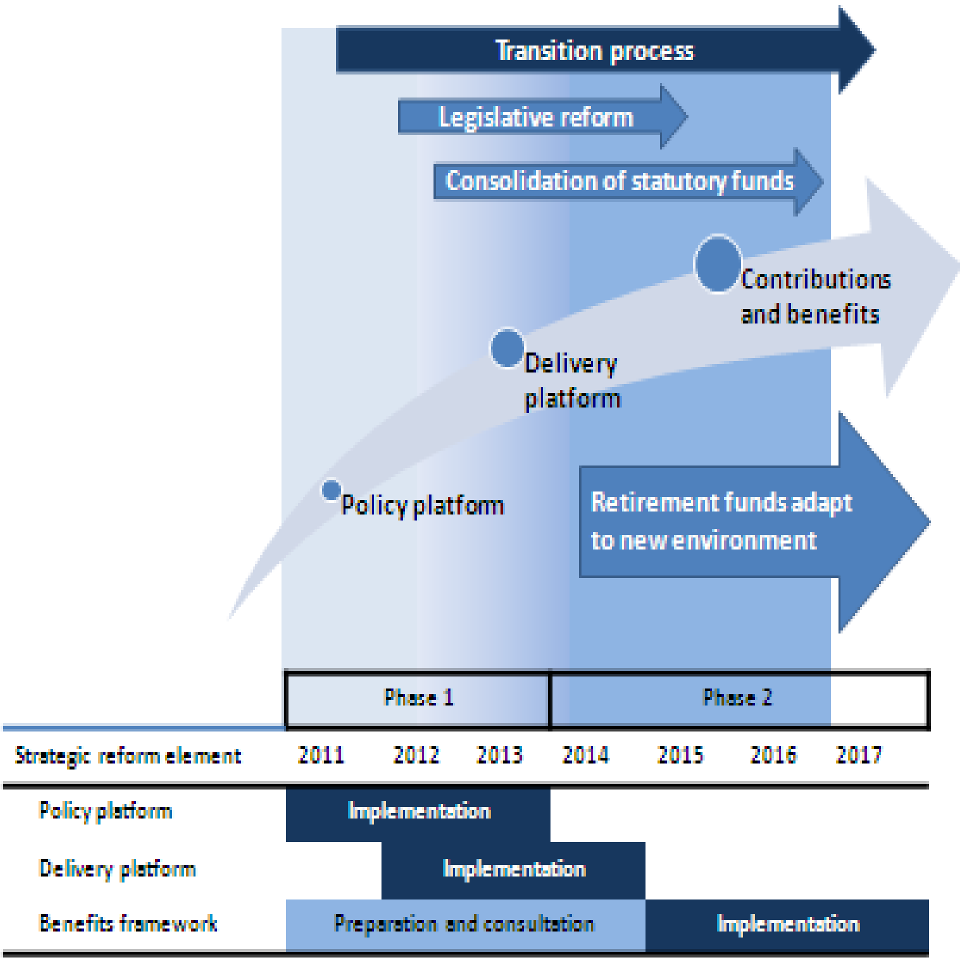
Workers will be urged to maintain or even increase their existing contribution levels, and will be encouraged to do so via a system of automatic enrolment.

**Public sector funds**

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.

***Observation**: These funds are typically defined benefit funds and this will be a significant change in employment conditions.*

**Figure 7 Proposed NSSF reform path**



## 6. Consultation and provisional reform timetable

This discussion paper is published for public comment. Government undertakes to engage stakeholders in an intensive consultation process to ensure that the 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 to ensure that the views of retirement fund members, organised labour, business and community groups are heard.

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,
2. Establishment of the NSSF and institutional consolidation,
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.

## Annexure A

## More detailed provisions relating to:

## 7. The National Social Security Fund

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. Withdrawal benefits will have to be preserved except in certain special circumstances. Contributions to the pension and risk benefit components of the NSSF will be pooled, sharing risk across all contributors.

Compulsory contributions: 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 R178 464) will not contribute on income above that level.

### Pensions

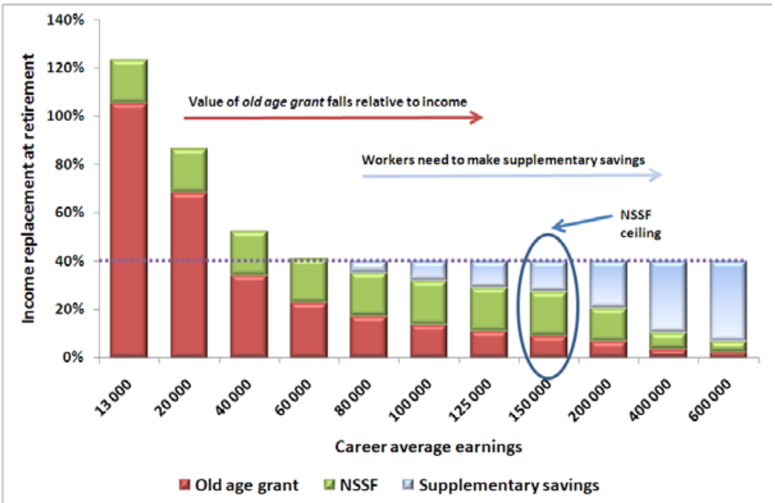
At retirement, a worker who contributed to the NSSF will receive a pension calculated according to a straightforward formula based on lifetime wages, length of service, and an accrual rate to determine what proportion of average earnings (up to the contribution ceiling) the worker would receive for every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

*Projected replacement ratio:* 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% target**




## Disability and survivor benefits

If a worker becomes permanently disabled, he or she will receive an income based on their salary at the time the accident occurred.

If a worker 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 for example 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.

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.

**Unemployment insurance**

Unemployment insurance will continue to be credit based but these credits will be accrued at a faster rate. 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.

**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.

### Supplementary retirement funds

Government will continue to incentivise top-up contributions to an occupational fund or private arrangement through the tax system.

A system of automatic enrolment is under consideration to encourage workers to make supplementary pension fund 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.

The NSSF will adhere to the same standards that are established for the approved supplementary 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 (i.e. umbrella 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.

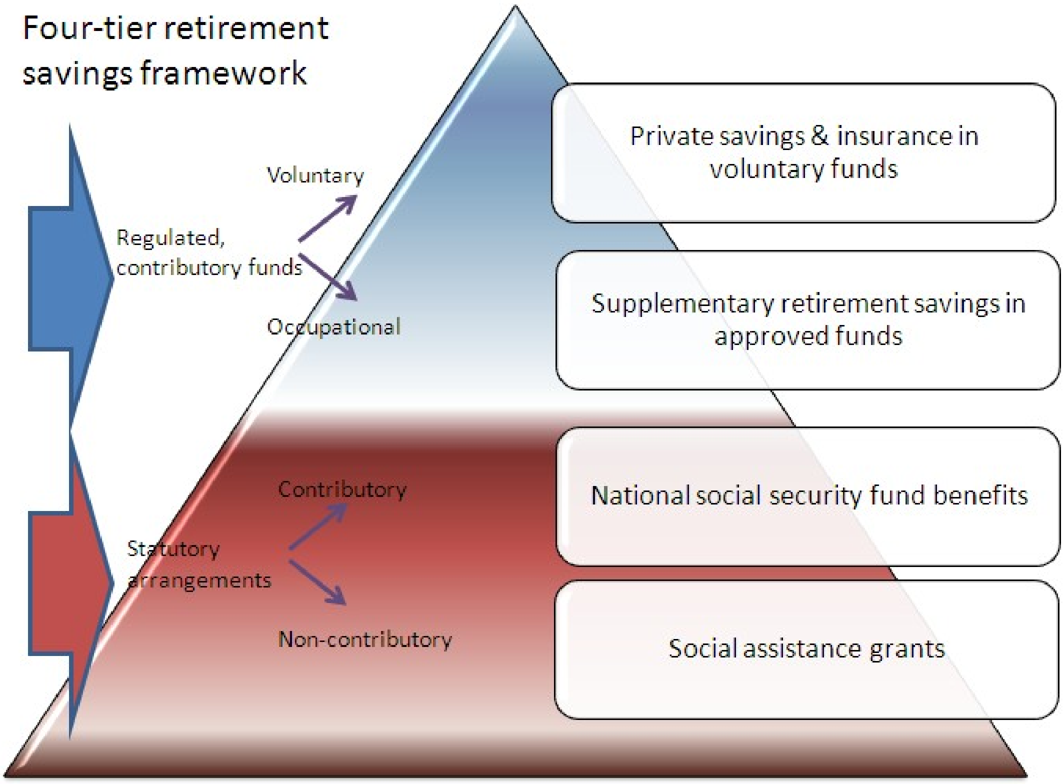
### Vested rights

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 of the paper, 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 Finance, institutions and the reform roadmap**



# 8. The funding model of the NSSF

### 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 of the paper 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. Detail of the proposed accrual rate and formulae were not given in the discussion document.

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 percent 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 sys- tem 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 retirement 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 maintaining 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.

*Possible Tax credit system:* 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. This is similar to the medical aid tax credit system that is already in place.

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 a semi-annual basis. In recent years, grants have broadly kept pace with prices rather than wages whilst the means test has been adjusted more aggressively in line with the phasing-out policy. 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.

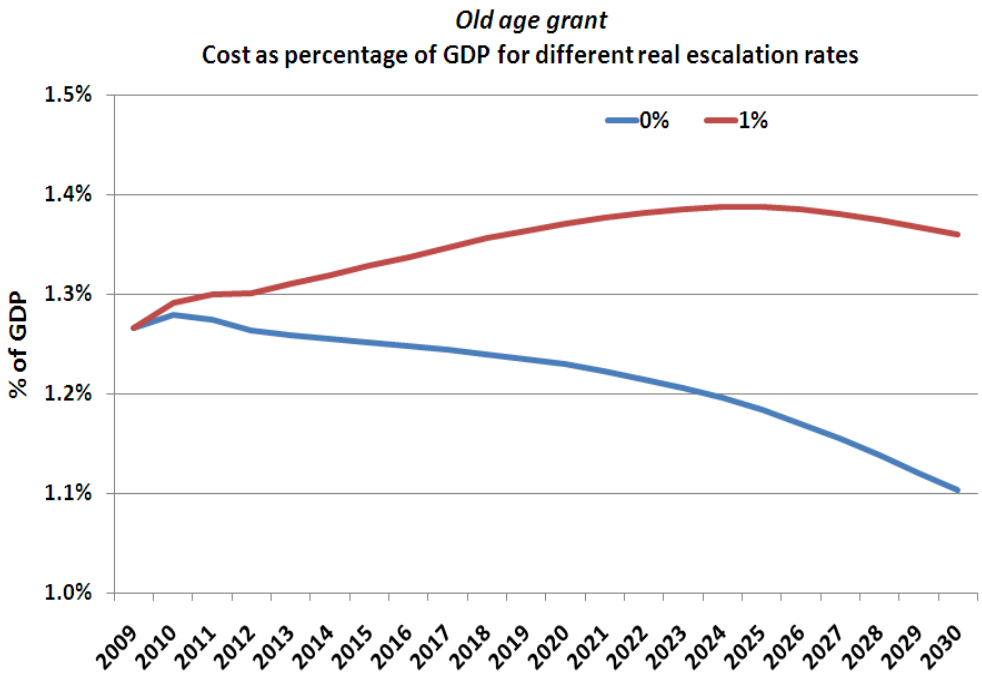
**NSSF**

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.