Department of Social Development: Inclusion of informal workers in the reform of retirement provision in South Africa (SD22/2008; OPM6669)

Consolidated Report

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Executive summary

South Africa has, relative to the rest of sub-Saharan Africa, **a well-developed social protection system spanning** social assistance (mostly non-contributory, means-tested cash grants), social insurance and private and occupational retirement and medical aid funds. The social assistance system forms the core of social protection in South Africa, and by the end of 2012/13 nearly 15.8 million people – out of a population of around 50 million – were beneficiaries of social grants. This is up from 13.1 million in 2009. Of this number, over a fifth are state old age pension (SOAP) recipients who currently receive a payment of R1,350 a month (approximately US$4.50 per day or double a fairly standard poverty line used in South Africa[1]). Plans are underway to provide universal access to the SOAP by 2016.

While **the SOAP ensures a base (minimum) level of income support for all senior citizens who are retired**, those with the means can use various forms of privately provided retirement mechanisms in order to improve their post-retirement income. Despite the fact that the private pensions industry is worth over R1.6 trillion (the amount of assets under management), the National Treasury (NT) estimates that only 'about half' of employed people (13.9 million) belong to a retirement fund and that **only 10% of South Africans have adequate savings to maintain their living standards into retirement**.

The first challenge in terms of retirement provision, therefore, is how to improve the current contributory, retirement savings mechanisms so as to ensure that more working individuals save and that they get value for money. **The current retirement environment has a number of challenges, including the fact that it is essentially voluntary in nature, there are high levels of withdrawals before retirement and low levels of annuitisation on retirement, and fund costs are high. These factors make good retirement provision unaffordable for most and lead to poor value for money for those who can participate. In response to these challenges, the South African government, as part of a broader set of social security reforms, has been exploring the introduction of a mandatory statutory fund that provides pension, life insurance and disability benefits**.

While the proposals developed by an Interdepartmental Task Team on Social Security led by the Department of Social Development (DSD) and the NT respond well to the challenges of those in formal employment (about 10 million individuals), **a second challenge in South Africa is that many informal workers will be left out of the formal retirement savings system and therefore face a drop in their standard of living when they retire.**

This consolidated report presents the results of a mixed-method (qualitative and quantitative) study carried out by a consortium of consultants led by Oxford Policy Management (OPM) on behalf of the DSD. The aim of the study was to look at the feasibility of the inclusion of informal workers in the current government-led reform of retirement provision.

1 See Finn and Leibbrandt (2013) and Statistics South Africa (2014).

Approach

The study had multiple phases, the first of which was an extensive literature review on social security systems (global and local) and the concept of informal work. This was followed by quantitative analysis of South Africa's Labour Force and Labour Dynamics national surveys, which have information on the numbers of people engaged in different types of informal work as well as their characteristics, such as earnings levels and frequency of work. Qualitative work was also carried out in the form of Key Informant Interviews (KIIs) and Focus Group Discussions (FGDs) with select groups of informal workers and informal workers' unions/organisations. These provided first-hand validation (or otherwise) of findings from the survey data. More importantly, the qualitative work revealed the nuanced characteristics of informal work and provided guidance on how solutions targeted at informal workers should be tailored. The next phase was primarily quantitative, involving actuarial modelling. The aim of this phase was to assess the appropriateness of different options (type of scheme – Defined Benefit (DB) versus Defined Contribution (DC), types and levels of benefits, contribution rates, etc.) for a pension and risk fund tailored for informal workers. The modelling also looked at the financial sustainability of such options, given different assumptions and scenarios. The study empowered the DSD by handing over the actuarial costing tool to them and also providing them with adequate training so as to allow them to use the tool to explore additional options and ideas, other than those presented in this report. Finally, the study looked at different options for an administrative platform for a retirement and risk benefits scheme targeting informal workers.

Characteristics of South Africa's informal workers

There are various ways of classifying or defining informal employment. For instance, according to the enterprise definition, individuals are defined as working in the informal sector according to the characteristics of the enterprise in which they work, i.e. if either the enterprise is not registered according to national tax or commercial legislation or if the employees of the enterprise are not registered according to national tax legislation. On the other hand, worker-based definitions give higher estimates of the extent of informality of the labour force since they focus on the characteristics of employment. For instance, an individual may be classified as informally employed if they are either self-employed and their business is not registered according to commercial legislation or if they are an employee without both paid leave and a pension.

According to the worker-based definition, in 2013 the number of informal workers in South Africa was estimated at 3.8 million individuals (3.58 million excluding agricultural workers) in a wide range of occupations and with varying income levels. While the survey data does not show growth in informal employment over time, there is evidence from sector-specific studies that indicates a trend of increasing casualisation of labour in the construction and agricultural sectors (as well as externalisation, for example in the clothing and horticultural sectors).

Using the worker-based definition, survey data shows that of those in informal employment, the majority **(58%) are informal wage employees and the remaining 42% are informally self-employed individuals**. In fact, South Africa differs from most developing countries in that the informally self-employed make up a smaller proportion of those in informal employment than informal wage employees. However, in South Africa, total self-employment makes up a small proportion of total employment. It is also interesting but not surprising to note **that informal employment is roughly equally distributed across the genders (46% female and 54% male). However, men make up a larger proportion of informal self-employment (59%) and women make up a larger proportion of informal waged employment (51%).**

Looking at the informal economy by industry, we find that **two industries together make up the largest portion of the informal economy – wholesale and retail trade (30%) and private households (26%).** Wholesale and retail trade alone makes up 48.3% of informal self-employment, highlighting the dominance of trade activity in the informal economy in South Africa. In contrast to this, informal waged employment is primarily characterised by employment in private households. A breakdown of informal employment by occupation reveals that the **largest occupational categories are elementary occupations such as street vendors, construction, mining and manufacturing casual labourers (28%), domestic workers (21%), craft and related trade workers (18%), and service/shop/sales workers (15%).**

Analysis of the survey data shows that a cumulative total of about 52% of informal workers earned R3,500 and or less every month and, of these, nearly 57% earned more than the value of the SOAP. Because of this, their earnings replacement once retired, in the absence of any other retirement provision scheme, will be low. Informal sector **earnings vary greatly by type of informal worker, by employment category and by gender. For instance, professionals (doctors, etc.) have the highest average monthly earnings with those who are self-employed, earning an average of R23,000 per month and with those who are waged earning R19,600. In the middle of the earnings distribution are craft and related trade workers, who have earnings between R5,000 and R6,000 per month, with wage-earning workers earning slightly more (on average) than those who are self-employed.** Generally, those in the private household and agricultural sectors earn the least (on average between R1,500 and R3,000 monthly).

Current social protection provisions for informal workers

Both globally and locally, a variety of attempts have been made to provide informal workers with social protection benefits, although challenges remain and coverage for those in informal employment remains low. For instance, social insurance systems can be successful in including informal workers, but much of their success depends on the design of the system.

Mandatory participation (e.g. in the Unemployment Insurance Fund (UIF) in South Africa) has seen only limited success in extending coverage (working fairly well for domestic workers but not for farm workers and taxi workers), and voluntary incentivised participation appears to offer much more potential. The key determinant of successful expansion is the creation of a scheme adjusted to the needs and circumstances of those operating in the informal economy. Successful systems have had **flexible contributions** (both in terms of the amount paid in and when the contributions are expected to be made). While some have **allowed withdrawals under special circumstances,** they often offer **subsidisation of contributions** and have **packaged a number of benefits into one system**. **They have also ensured that the system is as accessible as possible for those in the informal economy,** often by using existing infrastructure (including existing grant systems) or by utilising new technology such as mobile money, by increasing access to bank accounts, and have provided education on pension systems as well as information on specific schemes.

On the other hand, **schemes focused on specific occupations** have achieved some level of success in a few countries and offer some potential for expansion. Most notable has been the experience of welfare funds in India. The major advantage of welfare funds lies in the way in which they reduce the financial costs associated with the provision of social protection for both the government and for individuals by **financing benefits out of dedicated taxes levied on the industry or occupational group.** However, there are limits to the number of welfare funds that can be created and some occupational groups may be impossible to cover with this type of a scheme.

Agricultural workers are frequently covered by entirely separate schemes in both developed and developing countries. **Absa's funds for informal workers (including one for agriculture) are instructive as they only enrol people via employers – individuals cannot join.** The South African Music Rights Organisation **(SAMRO) is also interesting as the organisation makes a single annual contribution (R800**

irrespective of level of royalties earned) for each member who would have earned royalties in the year. These local examples – as well as India's system for informal workers – highlight **the importance of 'aggregators' or organisations that help in taking applications, collecting contributions and /or managing the registrations of groups of potential members and so bringing down the cost of enrolment and membership for both funds and potential participants.**

While in some cases employer organisations (e.g. AGRI SA) have no direct incentives, **aggregators can be incentivised** through a payment per registration approach, as is the case in Kenya and India. Potential aggregators can be identified as: Nodal offices/entities running certain schemes for identified beneficiary groups under central and state Governments; Micro-Finance Institutions (MFIs); Non-Banking Finance Companies (NBFCs); Non-Government Organisations (NGOs) and any other special interest organisations such as a workers' union.

Community-based schemes have shown only limited success in expansion of coverage and, even then, only in the area of health care. Moreover, they are largely **donor financed** and tend to offer limited benefits. On the other hand, **individual-level insurance schemes** have seen some success in extending social protection coverage in the form of micro-pensions. The successful experiences of several large MFIs offering micro-pension products have indicated the **high levels of willingness of informal workers (even those on low incomes) to pay into pension systems when these systems are designed in a way that understands their needs and circumstances (e.g. the need for flexibility in contributions).** The major limitation of these schemes relates to the relatively high level of contributions that participants have to make in relation to their income levels.

Consultations with informal workers in South Africa revealed that they would be keen to join a government-supported retirement scheme, given the fund:

- provides risks benefits, e.g. death, survivors and disability. Further, other benefits such as medical cover, education withdrawals, loan facilities, funeral benefits and unemployment benefits would improve attractiveness;
- allows flexibility in contributions due to variability in the timing and levels of incomes;
- is structured such that greater contributions translate into greater benefits and that there is transparency in the contributions and benefits structure;
- allows for the preservation of their accumulated savings in the event of non-payment;
- is administered through central government and not municipal authorities;
- is clearly identifiable as a legitimate government initiative and easily recognisable; and
- provides information and education to encourage participation instead of mandatory participation.

A retirement scheme for South Africa's informal workers

Benefits, contribution, costs and sustainability

After analysing global and local experience on the extension of social protection to informal workers, actuarial modelling was carried out in order to assess various options. The modelling suggests that **a voluntary DC scheme with smoothed returns would be a suitable option for informal workers.** This option combines the **flexibility and simplicity** of a DC scheme with **some guaranteed elements** that mean that the government, or the scheme as a whole, **share some of the individual members' risk**. Such a scheme will guarantee that the rate of return will never be negative, so the amount of an individual retirement account can never decrease. However, if the actual rate of return is positive, only a fixed proportion (e.g. 75%) of it will be credited to the retirement account.

It is also recommended for such a scheme that, at retirement, the member would be obligated to **use at least 75% (other options can be modelled) of the value of the account to buy an annuity**, and may take the remainder as a lump sum. **The terms on which the retirement account is converted into an annuity can also be guaranteed**, and only limited annuity options offered. The pension would increase with inflation during retirement, and be guaranteed for five years. **In addition, a survivors' pension of 25%** of the pension amount (split between spouse and dependent children) can **be paid on death in retirement.**

The smoothed investment returns provide some predictability to members, as do the guaranteed annuity returns. However, the requirement to buy an annuity, and the limited range of options, limit the flexibility. The investment smoothing introduces an element of complexity that may make communication of the benefits less easy. Furthermore, there is a slight risk of insolvency if actual investment returns are consistently poor or if the guaranteed annuity terms are too advantageous to members.

Generally, the retirement fund is likely to be attractive to most informal workers. **Although benefit levels will depend on contribution rates (or earnings level), it is clear that the SOAP will still be a significant source of retirement income for many informal workers**. While it is challenging to accurately predict potential replacement rates for DC funds, under a clearly laid out set of assumptions (e.g. on annuity factors) the actuarial modelling done reveals that, for a hypothetical male, aged 45, with an annual salary of R24,000 and contributing 5% of their salary, after purchasing an annuity and without the SOAP they will have a replacement ratio that is between 10% and 65% depending on the value of the lump sum taken (maximum possible lump sum set at 25% of value of retirement account). While the costing tool developed as part of this study allows policy-makers to explore alternative benefit designs and assumptions, it is clear that the SOAP will remain a significant source of retirement income for those on this income level.

The scheme should also offer disability, survivors and death benefits. In the event of disability, the scheme as presented in this report (to which alternatives can be modelled using costing tools) will offer a pension equal to 1.5 times the contributions made by the member in the last three years, payable until age 65, plus a contribution of 10% of each payment to the member's retirement account, if disability occurs more than three years after joining the scheme. In terms of survivors' benefits, the scheme should offer 1.5 times the contributions made by the member in the last three years, if death occurs more than three years after joining the scheme. Finally, in the case of death before retirement, a lump sum of R10,000 (inflating) will be payable, if death occurs more than three years after joining the scheme, or the value of the retirement account if death occurs less than three years after joining the scheme.

Given a series of assumptions, including that the scheme reaches 200,000 members in the first 10 years of its operation, it will be actuarially self-supporting over the next 45 years, with the assets in the risk fund set to decline after about 40 years. **However, this will depend on the government matching members' contributions at the rates described and also that it makes an extra contribution of R1 billion per annum for the first three years of the risk fund's operation.**

Administration

The pension administration platform will be critical to the success of the proposed fund for informal workers. The platform will have to be trusted by workers, will have to minimise the cost of participation to workers and minimise administrative and operational costs in order to ensure sustainability and attractive benefits (value for money) to beneficiaries. In this regard, the study recommends two main options. The first is an **intermediate option whereby overall governance will be the responsibility of the Ministry of Social Development (MOSD)** in close cooperation with the Ministry of Labour. In addition to driving the establishment of the fund, **the MOSD should also play a key role in initial marketing and outreach and eventually in monitoring and reporting on the performance of the fund**. The Fund should be established in terms of the Pensions Act and regulated by the Financial Services Board or such other regulator as may be established. **With regard to organisational governance, a Board of Trustees will have to be constituted.** Furthermore, it would be advisable for key functions to be outsourced and for the executive and the board to be set up with a tight focus on monitoring and supporting provision of services by service providers. In some cases it will be possible to outsource to other public providers, but these would still preferably be accessed through competitive processes.

While it may be possible for the fund to use the UIF or South Africa Social Security Agency (SASSA) as administrators, outsourcing this function to the private sector is another option. The same applies for fund management, where either **specialised fund managers or the Public Investment Commissioner (PIC) are alternatives**. Either way, risk benefits and annuities will be procured on the private market. To facilitate member registrations, **'aggregators' such as the sector-specific workers' organisations may be incentivised and an option can be to allow them to roll the scheme out under sector-specific brands.**

Recommendations

The study reaffirms the fact that informal workers cannot access retirement and risk benefits that provide value for money. Most informal workers have monthly earnings in excess of the SOAP yet the nature of their work has many characteristics (e.g. variable earnings, in terms of levels and frequency) that prevent them from participating in conventional retirement schemes. This means that many informal workers cannot maintain their standard of living, post-retirement. The current state of affairs it is also unfair as higher-income individuals access significant tax benefits from retirement contributions.

It is, however, also true that a contributory retirement system for informal workers is perhaps not government's most urgent priority as it deals more with (relative) benefit adequacy and not so much with poverty relief (it targets a group somewhat above the poorest).

Rather than immediately launching a big national scheme, other interventions may provide better value. More specifically, government should consider:

- **Monitoring and evaluating existing schemes (e.g. the Absa schemes for domestic and farm workers, the proposed Provident Fund for farmworkers from the Department of Labour, SAMRO's retirement fund, etc.). Value for money should be assessed and proposals made on how to reform and grow these schemes, specifically for occupational and sectoral groupings where there is more collective organisation. In addition, there should be more analysis of the performance of the UIF with regard to domestic workers and what lessons can be learnt from there (in the past there has been a problem with access to data). Such monitoring and evaluation will require a standardised evaluation matrix designed to assess efficiency and value for money of these types of funds**

- **Launching on a pilot basis, a smoothed defined contributory scheme. This can be modelled along the lines of the scheme presented in this report, but ways should also be found to experiment/pilot with different benefit packages and levels of subsidisation. For ease of implementation, the pilot(s) should be sector specific, targeting relatively well-organised sectors such as arts and culture workers, etc.**

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Abbreviations

AN	Arterial Network
COSATU	Congress of South African Trade Unions
CRA	Central Recordkeeping Agency
CWUSA	Creative Workers Union of South Africa
DB	Defined Benefit
DC	Defined Contribution
DSD	Department of Social Development
ECLAC	Economic Commission for Latin America and the Caribbean
FAWU	Food and Allied Workers Union
FGD	Focus Group Discussion
GDS	Gauteng Department of Sports
GEMS	Government Employee Medical Scheme
GSC	Gauteng Sports Council
ICLS	International Conference of Labour Statisticians
IDTT	Interdepartmental Task Team on Social Security and Retirement Reform
ILO	International Labour Organisation
IMC	Inter-Ministerial Committee on Social Security and Retirement Reform
IPIS	Individual Participant Information Sheet
KCB	Kenya Commercial Bank
KII	Key Informant Interview
LFS	Labour Force Survey
LMDS	Labour Market Dynamics Survey
MOSD	Ministry of Social Development
NAFU	National African Farmers Union
NBFCs	Non-Banking Finance Companies

NRRSF	Retirement, Risk and Savings Fund
NSSF	National Social Security Fund
NT	National Treasury
OPM	Oxford Policy Management
PAYG	Pay As You Go
PIC	Public Investment Commissioner
PFRDA	Pension Fund Regulatory and Development Authority (India)
PSL	Premier Soccer League
QLFS	Quarterly Labour Force Survey
SADSAWU	South African Domestic Service and Allied Workers Union
SAFPU	South African Football Players Union
SARS	South African Revenue Services
SAMRO	Southern African Music Rights Organisation
SANTACO	South African National Taxi Council
SASSA	South Africa Social Security Agency
SATAWU	South African Transport and Allied Workers Union
SOAP	State Old Age Pension
UIF	Unemployment Insurance Fund
WFP	Women on Farms Project

Glossary of terms

Term	Meaning
Accrual rate	This is the rate at which pension benefits build up in a defined benefit scheme.
Annuity	A series of payments made at stated intervals until the end of the agreed period or the life of the pension owner.
Benefit	Payment made to a pension fund member (or dependants) after retirement.
Contributory pension scheme	A pension scheme where both the employer and the members have to pay into the scheme.
Consumer Price Index	The consumer price index is the government's preferred measure of inflation since 2003. It measures a basket of retail goods and services, but it excludes certain costs such as council tax, mortgage interest, building insurance and house depreciation that are included in the Retail Price Index. CPI, which is the measure the government now uses to calculate increases in pension payments, has been lower than Retail Price Index since January 2010.
Decent work	Refers to opportunities for work that is productive, safe and delivers a meaningful income, security in the workplace and social protection for families, better prospects for personal development and social integration, freedom of expression and association, to organise and participate in the decision-making and equality of opportunity and treatment for all women and men.
Defined benefits pension	A pension scheme where the amount of money received at retirement is known up front, given meeting specific contribution minimums.
Defined contribution pension	A pension plan where the eventual retirement income is based on the amount of money paid in and the amount by which that money grows.
Economically active	All persons within the working-age group of 15 and above with the exception of the persons defined as economically inactive.
Economically inactive	All persons below the age of 15 and all persons over 15 who are not available for work since they are full-time learners or students, homemakers (people involved only in unpaid household duties), ill, disabled or on retirement (NSA definition).
Employed	All persons within the economically active population who have worked for at least one hour over the reference period for pay (remuneration), profit or family gain.
Employment rate	The proportion of the working-age population that is employed.
Guaranteed annuity	An annuity that is paid until the death of the annuitant. If this occurs prior to a certain date, the annuity is then paid to their dependants until that date.
Labour force	All persons who constitute the working-age group population aged 15 and above and are economically active. The labour force consists of both employed and unemployed persons.
Labour force participation rate	The proportion of the economically active population in a given working-age population group.
Old age Dependency ratio	The ratio of older dependents – people older than 64 – to the working-age population, i.e. those aged 15–64.
Pension plan	A contract that allows a member to receive an income after they have stopped working that may also offer additional benefits, such as disability, sickness, and survivors' benefits.
Replacement ratio	The percentage of pre-retirement monthly income that an individual receives from their pension.
Smoothed defined contribution	A defined benefit scheme with some portion that is guaranteed.

Term	Meaning
Survivors pension	Income received by those surviving a deceased pension owner.
Total dependency ratio	The ratio of all dependents – people older than 64 and younger than 15 – to the working-age population, i.e. those aged 15–64.
Unemployed (broad)	All persons within the economically active population or working-age group who are without work and available for work, irrespective of whether or not they are actively seeking work.
Unemployed (strict)	All persons within the economically active population who are without work, are available for work and are actively seeking work.
Unemployment rate	Unemployed persons (strict or broad) expressed as a percentage of the total number of persons in the labour force.
Vesting	This is when a person acquires non-forfeitable pension rights in a workplace pension scheme.

1 Introduction

Social security systems have a long history, having being developed in the late 1800s and early 1900s in what have now become developed/industrialised economies (Chen et al., 2002). These systems typically comprise four key elements: **social insurance,**[2] **social assistance,**[3] **family allowances**[4] and **national health systems**[5] (Chen et al., 2002).

Social security systems evolved under the assumption of a society in which there is full or nearly full formal paid employment. They therefore assume that individuals are able to make contributions throughout their working lives toward social insurance programmes and that state social assistance programmes cover the few who cannot provide for themselves or who need additional support.

In this context, the South African government – as part of a broader set of social security reforms – is exploring the idea of introducing a mandatory statutory fund that provides pension, life insurance and disability benefits (National Treasury, 2012). The rationale for the reform is that too few working South Africans save adequately for retirement, as the NT estimates that only 'about half' of employed people belong to a retirement fund and that only 10% of South Africans have adequate savings to maintain their living standards into retirement. The statutory fund is thus intended to address some of the shortcomings of the current retirement environment, including the essentially voluntary nature of the current system, high level of withdrawals before retirement, high fund costs due to the large number of private sector funds, and low levels of annuitisation (National Treasury, 2012).

The assumption of a society in which there is full or nearly full formal paid employment, however, does not hold in any developing country; in reality, less than full employment is the norm and often this employment is not formal. Informal work has become an increasingly common way for people in such countries to fend for themselves and there is evidence that this trend is on the rise.

To date, the exploration of a set of broader reforms to enhance savings and retirement provision among South African workers has largely been focused on formal workers. The existing government proposal for a mandatory statutory fund that provides pension, life insurance and disability benefits at this stage only covers formally employed workers. However, as research shows, South Africa has a large informal sector and workers in this domain need to be targeted in social security reform as well. Realising that the latest social security reforms in South Africa that include the SOAP and UIF have not specifically addressed the relevance or appropriateness of the reforms to informal workers, the DSD commissioned a study on the inclusion of informal workers in the reform of retirement provision. This consolidated report presents the outcomes of the study that was conducted.

The report consists of eight chapters. Chapter 2 provides a background to social security systems, outlining what they are, where they originate and, most importantly, why a sound social security system is important for a country such as South Africa. Chapter 3 provides an introduction to informal work as a concept. The chapter discusses the issue of informal work and worker definitions and the implications thereof in sizing the informal sector and identifying the key characteristics of informal workers such as earnings levels, etc. Chapter 4 discusses the lessons learnt from international and local attempts to extend social security reforms to informal workers. In this chapter, case studies from South Africa and the rest of the world are

2 Against expected contingencies such as old age, unemployment, death, disability, etc.

3 For those facing particular hardship due to 'uncommon' contingencies.

4 In the form of benefits for people with children.

5 To provide individuals with access to health care.

presented, together with some of the main challenges and successes that arose from the various approaches used thus far.

Chapter 5 presents the government proposal for a mandatory contributory pension fund for (formal) employees in South Africa. In this chapter, the government's proposal of a formal mandatory contributory pension is used as a base that is discussed and tested on a number of informal workers. The main purpose of this is to identify some of the problems that options for provision for informal workers may need to overcome. The chapter also includes KIIs with different informal workers' organisations that currently have some market arrangements for retirement savings such as provident funds, etc. Chapters 6 and 7 present the options that can be considered for provision in retirement for informal workers in South Africa. Chapter 6 focuses on the proposed contributory system for informal workers, including the size of contributions per informal worker, potential government support for the scheme, potential benefit structures and replacement rates, as well as the sustainability of the fund. On the other hand, Chapter 7 focuses on the governance options for administering the fund. Here, two options for an administrative platform are presented, combining lessons from international experience and an insightful understanding of the existing government administrative structures. Chapter 8 summarises the previous chapters in the report and provides the final recommendations and conclusions.

2 Background

Social security systems in their prevailing form have ensured that the vast majority of those in developed countries are afforded a basic level of protection throughout their lives. Coverage in OECD countries is very high, with International Labour Organization (ILO) data suggesting that around 90% are covered by social security systems (Chen, 2007). Many developing countries have attempted to replicate this model, but their institutions, socio-economic circumstances and labour market characteristics differ from those of developed countries in ways that make it difficult to achieve the same degree of coverage. Therefore, a large number of people in developing countries, many of whom operate in the informal economy, are left unprotected, and few are included in structured pension arrangements (Hu and Stewart, 2009). The bottom end of the coverage spectrum includes many sub-Saharan African and South Asian countries, which have coverage levels as low as 10% of their total populations.

A major reason for these low levels of coverage relates to the labour market assumptions that have guided the design of social security systems, as these do not match the reality in developing countries. This includes not only the assumption of full employment (which is unlikely to be the case in a developing country context) but also that of full *formal* employment (as developing countries are characterised by high levels of informality in employment). Protection under traditional social security systems is therefore generally restricted to those linked to the formal labour market, leaving a large portion of the workforce uncovered in developing countries. The contingencies covered by these systems (guided by ILO lists of contingencies, which themselves are guided by assumptions on the formality of employment) are also unlikely to match the priorities of those in informal employment, who tend to have lower and more variable incomes. This makes voluntary participation in these systems less likely, as the contingencies covered are unlikely to match the needs of those in informal employment.

However, it is not only the inappropriate assumptions guiding the design of the system that have created low levels of coverage in developing countries. Even if systems were based on more realistic labour market assumptions and the appropriate contingencies were covered, informal economy workers are an inherently difficult group to cover for a number of reasons. Informal workers can be difficult to reach as many are situated in remote locations. Their incomes are irregular and tend to fluctuate from month to month, making it difficult for them to contribute a set amount on a regular basis. Many informal workers do not use formal bank accounts as financial institutions are often regarded with a high level of distrust (MacKellar, 2009) or because there are simply no financial products available that are appropriate for their needs. Financial literacy tends to be lower among the informally employed and few have any exposure to social security systems or financial institutions in general. Many informal workers have a high liquidity preference, with savings being of a precautionary nature rather than for longer-term purposes. They are consequently less likely to prioritise savings for retirement. Informal workers can often only afford to make small contributions into social insurance systems, which increases transaction and administration costs and decreases the value of the (already low) expected level of benefits they would receive. Compounding these difficulties is the fact that the majority of those working in the informal economy are self-employed and hence do not have employers to make co-contributions into social security systems on their behalf, which increases the burden on them in terms of contributing into the system. Indeed, even developed countries with otherwise high levels of coverage and good administrative systems experience difficulties in including the self-employed in social security systems (Choi, 2009).

Despite these difficulties, the informal economy has received more attention in recent years and various attempts (with varying degrees of success) have been made in a number of regions to provide or extend social protection to informal workers. In this vein, state-provided social assistance and social insurance schemes have been adapted in an attempt to expand coverage to the informal economy. Furthermore, some market-based occupational and individual-level schemes have been created to capture some of the informal economy market and a number of community-level schemes that address informal workers' needs have been put in place. Table 2.1 outlines some examples of where some level of coverage for informal workers has been extended. Risk areas (e.g. old age, unemployment, etc.) are indicated on the left and forms of protection (e.g. state-provided social insurance, market, occupational, etc.) are indicated across the top of the table. Ticks indicate areas in which examples can be found of attempts to include informal workers according to each risk area and form of protection.

Table 2.1 Examples of extension of social protection to informal workers

Risk area	Form of protection				
	State: Social assistance	State: Social insurance	Market (occupational)	Market (individual)	Community
Old age	✓	✓	✓	✓	✓
Survivors		✓		✓	
Death		✓	✓	✓	✓
Disability	✓	✓	✓	✓	✓
Family and children	✓	✓		✓	
Unemployment	✓	✓			
Health care	✓	✓		✓	✓
Funeral		✓		✓	

An overview of each of the various forms of protection and the ways in which informal workers have been included (whether successfully or unsuccessfully) can be found below.

2.1 State-provided social assistance

Social assistance programmes exist in a large number of countries throughout the world.[6] These programmes are non-contributory and tend to be funded through general tax revenues. They can either be universal and therefore available to everyone in the country (e.g. the Bonosol Programme in Bolivia, which provides a universal pension to all citizens over the age of 65 (ECLAC, 2006)) or means-tested and therefore available only to those with income or assets below a certain threshold (e.g. the SOAP in South Africa). Universal systems offer a minimum level of protection (poverty relief) to the entire population, while means-tested social assistance programmes attempt to offer protection only to those who are most vulnerable. Social assistance programmes have occasionally attempted to target certain geographical groups who are likely to be particularly vulnerable. An example of this is Brazil's *Previdencia Social Rural*, which provides basic pension and survivors' benefits to the old and disabled in informal rural employment (Barrientos, 2002a). Social assistance can also come in the form of cash grant systems. Cash grants are frequently targeted at low-income households with children and are sometimes contingent upon school attendance and regular health checks. Examples of cash grant systems can be found across Latin America and in an increasing number of developing countries in other regions, including a number of African countries (Barrientos, 2007).

Social assistance programmes provide protection for a variety of contingencies. Examples can be found of social assistance schemes addressing income security in old age (e.g. the SOAP system in South Africa), disability (e.g. the *Previdencia Social Rural* in Brazil), unemployment (e.g. labour-intensive public works in

6 A number of countries in the South African Development Community (SADC) have state-provided social assistance, including South Africa, Botswana, Lesotho, Namibia, Swaziland and Mauritius (OPM, 2010). Bolivia, India, Bangladesh (MacKellar, 2009 for details) and Nepal have all put non-contributory pension schemes in place over the course of the last decade, while Argentina, Brazil and Chile have all strengthened existing programmes (Barrientos, 2007).

India) and sickness (e.g. universal health systems in Jamaica and Thailand). However, the common objective of social assistance schemes is to reduce poverty and provide a basic level of income security to those who are most vulnerable. While not specifically targeted at those in informal employment,[7] in reality many informal workers fall into the group of those most vulnerable in many countries and are often captured within these systems. For many informal workers, this is the only form of protection that they have access to.

Social assistance programmes tend to achieve a high level of coverage, particularly when the schemes are universal. They have been found to have a number of positive effects, both in terms of their primary aims (i.e. reduction of poverty and vulnerability) and in terms of a number of dynamic secondary effects (including improving school enrolment and attendance of children in beneficiary households and helping individuals move from low productivity to higher income-generating activities (Barrientos, 2002a)). However, some express concern about the fiscal impact of social assistance programmes (MacKellar, 2009). As they are non-contributory, they have to be funded from tax revenues and can create a heavy fiscal burden for government. This is particularly true for those countries with high levels of informality that have the combined problems of having a small tax base along with large numbers of people in need of social assistance.

While social assistance forms an initial tier of protection for some informal workers, these systems are by no means comprehensive. For those who are eligible for social assistance, the protection they are afforded is minimal and will simply keep them above the poverty line, sometimes not even that. Some informal workers may not have access even to this basic form of protection, particularly if the systems are means-tested, and universal systems are often seen as fiscally infeasible in countries with the highest levels of informality. Social assistance is best seen as a provider of basic income security for some informal workers, but for many in the informal economy social assistance programmes are likely to remain an inadequate means of protection and will require supplementation with other programmes.

2.2 State-provided social insurance

In contrast to social assistance, the main objective of state-provided social insurance is the smoothing of income over a lifetime (i.e. the provision of earnings-related benefits) rather than poverty reduction (OPM, 2010). Social insurance programmes therefore have a slightly different purpose to social assistance programmes and provide an additional tier of protection. The two systems also differ in terms of their funding – social insurance programmes are contributory and are generally funded from contributions made from individuals and employers who are members of the programmes (often with some level of government subsidisation). The level of benefits afforded are generally linked in some way to the level of contributions that members make (hence the focus on smoothing of income).

Social insurance programmes can be designed to cover a package of contingencies. These commonly include a pension component as well as coverage of risks such as disability, death, unemployment, and sometimes also protection in the form of survivors' benefits and health care. National social insurance programmes are the norm in developed countries and have been in place since the early 1900s. Similar systems have since been adopted in other regions of the world. Many Latin American countries chose to adopt similar social security systems after the First World War, followed by a number of African countries after the Second World War (Keizi, 2006). However, as formal national systems were initially based on those adopted by developed countries, these systems have proved inadequate as a means of protection for the bulk of those living in developing countries. The schemes are generally restricted to those in formal sector employment (and generally those with relatively high incomes) and consequently have had low coverage rates (OPM, 2010).

7 Brazil's system targeting rural informal workers is an exception here.

The weaknesses of these systems in addressing protection in the context of a developing economy, particularly their weakness in terms of covering those in the informal economy, have been recognised and many countries are attempting to redesign their systems in a way that better captures those in informal employment. However, the extent of the problems that have been experienced even in developed countries attempting to include self-employed workers in social insurance systems is indicative of the difficulties countries are likely to face in capturing non-formal wage employees in social insurance systems. Because the self-employed are more difficult to monitor and have no employer to make co-contributions, even countries with high levels of administrative capacity and high levels of compliance for wage employees experience low levels of compliance for those who are self-employed. A good example is that of the US, where compliance among wage employees is almost universal (at 96%) whereas among the self-employed it is only around 50% (Schwarz, 2003). Many OECD countries have created entirely separate systems in an attempt to capture the self-employed into social security systems (Choi, 2009).

Attempts to address the problem of inclusion have taken on two main forms. These have included either mandatory participation in a system or making participation voluntary while simultaneously creating incentives to increase participation. These two forms are discussed in the sub-sections below.

2.3 Mandatory participation

Countries have occasionally tried to increase participation of the informally and self-employed via mandating participation in the system. Sometimes this participation has been made mandatory for all those who are informally or self-employed in the country (for example, in the Philippines, Chile, Mozambique, Tanzania and Swaziland) and in other circumstances mandatory participation applied only to specified sub-sets of occupational groups (e.g. domestic workers in Peru, Costa Rica and South Africa).

A problem with mandatory participation is that it is very difficult to enforce, as the very nature of informal and self-employment makes tracking workers difficult. Even if compliance were able to be strictly enforced (which has been possible in some countries such as Australia but is unlikely to be the case in most developing country contexts) (Hu and Stewart, 2009), mandatory participation relies on these individuals being both willing and able to contribute into the system. Systems that have blindly assumed that both these conditions have been met and simply mandated participation without taking into account the circumstances of those in informal employment have not experienced much success in terms of coverage. Tanzania is an example where self-employed workers are obliged by law to contribute to the national social insurance scheme, but coverage remains extremely low with less than 2% of the economically active population covered by national social insurance (OPM, 2010). Argentina has experienced similar problems, with a social insurance fund dedicated exclusively to self-employed workers (*Caja de Autonomos*). However, evasion of the system was common, with only half of the self-employed contributing despite contributions being made mandatory (Barrientos, 2002a). Experience in other Latin American countries has been similar; despite mandating participation, coverage did not expand significantly (Schwarz, 2003). Many of those in informal employment have a low capacity to contribute and may remain unwilling to participate (Choi, 2009). Even if willing to participate, their circumstances often require more flexibility than most formal social insurance systems allow.

Mandatory schemes that have seen success in expanded coverage have either focused on particular occupational groups whose circumstances make it easier to include them in the system (e.g. domestic workers with a formal, identifiable and often long-term employer) or have mandated participation while ensuring that the system is designed in such a way as to ensure that informal workers are able to pay in. The Philippines had some initial success in this regard. After mandating participation in the social security system for self-employed workers in 1997, there was a tripling in coverage of informal workers in the space of 10 years (MacKellar, 2009). Importantly, the system simultaneously addressed a major obstacle faced by informal workers by expanding access to bank accounts and ensuring that the system allows for small regular contributions into the bank account from which social security contributions are made. They have also worked through cooperatives and people's organisations to encourage members to pay into the system and act as accessible and trusted collection agents (MacKellar, 2009).

2.4 Voluntary incentivised participation

Mandatory participation can be difficult to enforce and may not always be in the best interests of many informal workers. Forced participation in a system that has been designed for people operating under very different circumstances may actually cause the informally and self-employed additional hardship rather than alleviating some of the risks that they face. While many countries have allowed voluntary participation for the informally and self-employed, few of these have been successful without some form of adjustment being made to the traditional structure of the system. If the system is simply opened to voluntary participation without any adjustments, coverage tends not to expand very much. A lack of voluntary buy-in into social insurance systems has been a common experience in many SADC countries that have opened their social insurance systems to voluntary participation (OPM, 2010). Many countries are now taking what appears to be a more feasible route, allowing voluntary participation for informally and self-employed workers while simultaneously adjusting the system to make it accessible and encouraging participation through added incentives.

Incentives for participation can come in a number of different forms. The most common include government subsidisation, introducing flexibility into the system, allowing withdrawals in special circumstances, packaging a number of benefits together, increasing the accessibility of the system, and increasing awareness through education and information. Often, several of these incentives are combined.

2.4.1 Government subsidisation

In national social insurance systems, employee contributions are typically subsidised by employer co-contributions (Choi, 2009). Those who are formally self-employed or informally employed are at an automatic disadvantage in the system as they either make far lower contributions (with correspondingly lower benefits) or are unable to pay an amount equal to that paid by formal wage employees. In an attempt to address this problem, many developed country systems subsidise the contributions of those who are self-employed. For example, Austria has a system of 'partner co-payment' supplementing the contributions made by the self-employed and financed from general revenue (Choi, 2009). Many developing countries have also chosen to incorporate subsidies into their attempts to expand access to national social insurance systems. Mexico has recently been successful in this regard. An important aspect of the Mexican reform was the move toward individual accounts whereby the government co-contributes a fixed amount to incentivise participation (Reyes, 2008). Apart from co-contributing to systems during an individual's working years, governments may also subsidise the system in other ways. Sometimes, the subsidisation has come in the form of 'topping up' an individual's contributions upon reaching retirement if the contributions they have accumulated fall below a particular threshold. This system is used in Chile to ensure that those who have made contributions over their lifetime are able to access benefits in retirement (Shah, 2005).

2.4.2 Flexibility

One of the most important differences between formal wage employees and the informally or self-employed is the level of predictability of income that an individual experiences. Informal or self-employed individuals have incomes that are more irregular and fluctuate from month to month. Seasonal workers in particular experience large income fluctuations, receiving most of their total annual income in the space of a few months and little or nothing in other months. This irregularity and unpredictability make it difficult for workers to contribute into a social insurance system that requires a set monthly contribution. Governments have tried to address this problem by allowing the system to be more flexible, either by allowing flexibility in terms of contribution amounts, by allowing flexibility in terms of when payments can be made, or by a combination of both. For example, Chile's system allows for irregular contributions from temporary and seasonal workers in order for their contributions to correspond more closely with the irregularity of their income streams (Hu and Stewart, 2009). In this way, the system has flexibility in terms of when workers can contribute to the scheme.

The Government of Ghana recently introduced a special scheme for the informal sector that introduces flexibility in relation to the contribution amounts that workers pay into the scheme. In the Ghanaian scheme, workers are able to elect the amount that they pay in, but this amount needs to be paid on a monthly or regular basis (i.e. they do not have flexibility in terms of when/how often they pay into the scheme, only flexibility in the contribution amount) (Government of Ghana, 2010). Combining the two systems, a pilot farmer's scheme in Vietnam allowed for flexibility in contributions both in terms of how often payments were made and in terms of the contribution amounts paid. Although a quarterly minimum contribution amount was set, contributors could choose to pay quarterly or semi-annually and they could choose the amount paid in as long as they paid at least the quarterly minimum (MacKellar, 2009).

2.4.3 Withdrawals

Informal workers are likely to have more pressing immediate needs to be addressed than savings for retirement and often have a higher liquidity preference than formal workers with higher and more regular incomes (MacKellar, 2009). Their savings tend to be precautionary in nature rather than long term because lower-income informal workers have fewer personal buffers to protect themselves from unexpected events and emergencies. In order to address these shorter-term concerns, some countries have incorporated a system of pre-mature withdrawals that are allowed to be made from an individual's account under certain circumstances. A system of withdrawals helps to complement the longer-term income smoothing role of social insurance systems by incorporating an additional consumption smoothing role in the short run during periods of need (Shah, 2005). For example, withdrawals can be made from the pension system in Australia in limited exceptional circumstances on compassionate grounds or during periods of financial hardship (Hu and Stewart, 2009).

Withdrawals can be used for a variety of circumstances, such as emergencies, periods of unemployment and during periods of illness. Sometimes, withdrawals are allowed for certain investments, such as in housing and in children's education. A system of withdrawals does, however, have to be well designed and limited to exceptional circumstances, as too much leakage from the system can undermine it and reduce the benefits afforded to individuals upon reaching retirement. Ghana has recently introduced a voluntary special pension for the informal sector. Informal workers pay into a system that creates two accounts: a retirement account and a personal savings account. No withdrawals are allowed from the retirement account (thus protecting their retirement benefits at a later stage), but the personal savings account has rules for withdrawals before retirement. Withdrawals are allowed for certain investments, such as education or business enhancement (Government of Ghana, 2010), and focus on those investments most highly prioritised by those in the informal economy.

2.4.4 Packaging of benefits

As mentioned previously, informal workers are likely to prioritise more immediate needs over savings for retirement due to their lower and fluctuating incomes. Systems that are designed in a way that addresses the needs and concerns of those in informal employment (i.e. those that include benefits that address these immediate needs) can be assumed to have higher levels of uptake than those aimed exclusively at retirement benefits. Social insurance systems that package retirement benefits with other risk benefits (such as death, disability, unemployment or funeral benefits) are likely to be more attractive to informal sector workers, because the benefits are likely to address some of their more immediate needs and concerns.

2.4.5 Accessibility

Informal workers may encounter access problems if they are not linked into other existing formal systems, such as formal financial systems or government grant systems, or if they are situated in remote locations. Many informal workers encounter significant barriers in accessing even the most basic of formal financial services (e.g. savings accounts) and rely instead on informal financial services. This lack of access to financial instruments can compound the difficulties they face in contributing to social insurance mechanisms if these are collected through formal banking systems. The Philippines attempted to address this problem by expanding access to bank accounts for those in rural areas and linking these accounts to the national social insurance system (MacKellar, 2009). Mexico attempted to address access issues in a slightly different way, instead linking the existing grants system to the national social insurance system in order to facilitate access to the social insurance system for those already incorporated into the grants system (Shah, 2006). For those in rural areas, collections may need to be coordinated at a community level. In a pilot farmers' scheme in Vietnam, contributions were collected in the communities in which contributors lived, they were issued receipts and then the money was paid into an account at the district agricultural bank and then transferred to the provincial level (MacKellar, 2009). This system bypassed the need for formal bank accounts and ensured that contributions were easy to make, with individuals making contributions within their own communities.

2.4.6 Awareness through education and information

Voluntary participation in a social insurance system relies to a certain extent on a minimum level of financial literacy among informal workers, as well as an awareness of existing schemes. A recent survey in India indicated that 80% of informal sector employees did not know what a pension was (Hu and Stewart, 2009). Public awareness campaigns can play an important part in increasing awareness of pension plans in general and of the particular schemes open to informal workers in particular. Many informal workers who are both willing and able to contribute to a system may not do so simply from a lack of awareness. China has attempted to address this problem via training for local social security bureau officials to ensure that they can effectively explain the existing social security system available in the country to those in rural areas (Hu and Stewart, 2009).

2.5 Occupational schemes: market based and state governed

While private occupational schemes have traditionally been restricted to formal employment arrangements, there have recently been some examples of public schemes that have specifically targeted informal workers in particular occupational groups. A wide variety of such initiatives have been implemented in a number of different countries. Those in agricultural employment or residing in rural areas have been targeted in occupational schemes. Examples of occupation-based schemes include statutory social security for home-based embroiderers in Madeira, rural pension programmes in Brazil, pilot farmers' schemes in Vietnam, and agricultural workers' pension schemes in India.

Welfare funds in India represent an interesting example of schemes aimed at providing informal workers in particular occupational groups or industries with social protection benefits. India has a large informal economy, with 93% of the labour force working in informal employment. Welfare funds deal with two problems that the informal nature of work creates in relation to providing social protection: they bypass the need for a direct employer–employee relationship while also bypassing the need for government to fully cover the cost of social protection provision for these groups. This is done by imposing a levy (known as a '*cess*' in India) on the output of a particular industry (Chen et al., 2002), making the funds semi-contributory. Examples include levying a small tax on the sale of *bidis* (hand-rolled cigarettes) for the *Bidi* Workers Welfare Fund or a small *cess* collected on the basis of the cost of a construction project for welfare funds for construction workers. The money is put into a special fund administered by the Ministry of Labour and monitored by tripartite boards. Most welfare funds exist at the state level; however, there have also been examples at the national level (for example, the *Bidi* Workers Welfare Fund (Government of India, 2010)). These funds provide people working in designated sectors with a wide variety of social assistance benefits and services, including pensions, disability and death benefits, medical aid, housing allowances and school scholarships for children. A large number of welfare funds have been put in place in several states for various categories of workers, including construction workers, truck drivers, footwear workers, agricultural workers, fishermen, film and cinema industry workers, weavers and *bidi* workers (Government of India, 2010). Other countries have attempted to replicate this model. An example is the Philippines, which has experimented with welfare funds for plantation workers.

One occupational group that is frequently afforded special treatment and covered by separate occupational schemes, even in developed countries, is workers in the agricultural sector. Separate schemes for farmers are in place in a number of countries, including Austria, Finland, France, Germany, Greece, Luxembourg, Poland and Spain (Choi, 2009). Sometimes, farmers are grouped into the schemes that are available for the self-employed but these are also frequently set up as entirely separate schemes. Participation in these arrangements can be either mandatory (as in France) or voluntary (as in Hungary). Pension schemes for farmers are generally accompanied by concessions in contributions and government subsidisation (Choi, 2009). These subsidies range in size but are often fairly substantial. In Austria, Finland and Germany, the governments pay three-quarters of the farmer's total pension contributions, whereas in France the government subsidises 82% of the contributions and in Poland the subsidy is as large as 95% (Choi, 2009). Vietnam has had a voluntary farmers' pension fund in place since the 1980s. The scheme allows for flexibility in contributions, making it more accessible for farmers, but the frequency of withdrawals and low levels of contributions have resulted in low levels of benefits (MacKellar, 2009). Agricultural schemes have therefore faced a number of problems, either in terms of their fiscal cost or in terms of the benefits they have been able to provide.

Brazil has implemented a system that operates somewhere between that of a welfare fund and a targeted agricultural scheme. The scheme targets rural areas, thus using a geographical targeting rather than focusing on an occupation group. However, the geographic target is likely to capture many of those in agricultural occupations. The scheme is partly financed out of taxes levied on the sale of agricultural products (ECLAC, 2006) and hence shares some of the financing traits of a welfare fund, although the rest of the financing comes from general tax revenues. Qualification for benefits from the scheme requires an individual to have had a minimum level of 12 years of work activity in the agricultural sector. The initiative has been successful in reducing poverty and vulnerability in traditionally rural areas of Brazil (see Section 4.3 for details of the Brazilian case).

Many occupational state-initiated schemes have been very successful in expanding protection to those in informal employment in a way that minimises fiscal strain for governments and financial strain for individuals. While they offer a great deal of potential for expansion of coverage elsewhere, there are a number of drawbacks to occupational schemes. First, these schemes rely on a minimum level of formality in that they require workers and contractors to be registered and fragmentation and lack of organisation may make them difficult to implement in other countries (Mehrotra and Biggeri, 2002). Second, they do not take into account the fact that workers may not necessarily remain in the same occupation throughout their lives. Third, informal workers are active in a wide variety of value chains and in a wide variety of occupational categories. There are limits to how many occupation schemes can feasibly be set up in a country, so there will always be some gaps in coverage for certain groups of informal workers even if a large number of occupational schemes were to be put in place. Finally, certain occupational groups are subject to high levels of risk. For example, farmers are at risk due to adverse weather conditions and a large number of workers within a scheme seeking benefits at the same time would put strain on an agriculture-focused scheme.

2.6 Individual-level insurance (market based)

Many of those working in the informal economy cannot afford the high premiums of private insurance mechanisms (Chen, 2007). Moreover, payment to private schemes can be problematic not only for those with low incomes but also for those in higher income brackets. This is because they have incomes that fluctuate or are irregular and they consequently lack the level of predictability in earnings necessary to make the predictable (and often high) payments that are required of market-based individual-level insurance. Many of those in informal employment lack access even to basic formal savings mechanisms[8] and these access problems tend to be even worse for formal insurance instruments. Nevertheless, there have been some examples in recent years of successful inclusion of informal workers in individual-level insurance in the form of micro-insurance and micro-pensions. These schemes, where they exist, have been successful in facilitating social protection for a variety of contingencies, including old age, death, disability, health care and funeral cover.

Grameen Bank in Bangladesh represents one such example. Grameen Bank is an MFI that over time has diversified its business from microcredit and micro-savings toward providing micro-insurance and micro-pensions as part of their packages. While Bangladesh has a means-tested non-contributory pension system (the Old Age Allowance Programme), many informal workers are just above the means test’s cut-off point and hence face a lack of income in old age. Grameen Bank responded to this by developing an old age pension fund and offering pension savings plans. Borrowers taking out loans above a certain amount (above BDT 8,000/138 USD) are required to save a small amount each month (BDT 50/USD 0.72) into a personal pension savings account over the course of 10 years. These DC savings plans have been developed with a high degree of understanding of clients’ needs and hence a high level of flexibility has been built into the system. Payments can be made into the account on any day of the month, advance payments are allowed, and the charges applied to the account are minimal (with a one-off admin fee for opening the account and a small penalty in the event of early closure of the account). The only aspect of the savings scheme that is not flexible is the minimum monthly contribution. If the monthly contribution is not paid, the account is automatically closed (MacKellar, 2009).

Other successful examples include similar microfinance initiatives in India. The Unit Trust of India (UTI) has been involved in similar initiatives to expand pension coverage to those in the informal economy in the form of micro-pensions. UTI’s micro-pension scheme was launched in 2005 and is currently the largest mutual fund in India (Pension Development Network, 2010a). The system is more flexible than Grameen’s in that there is no mandatory minimum to be paid monthly. In fact, participants have the flexibility to choose how often they pay in (either monthly or annually), as well as their contribution amount (ranging from US$ 0.72 to US$ 2.88). The money is pooled and invested in bonds and equities to obtain a return. Pension benefits are paid out when the participant reaches the age of 58 (Pension Development Network, 2010b). UTI is not, however, the only micro-insurance provider in India. In fact, there are over 60 schemes across the country covering around 5.2 million people (ILO, 2006). The benefits provided are also wider than simply coverage for old age, including insurance for death, disability and health care. The schemes differ in that some target specific groups (e.g. voluntary savings schemes for self-employed women (MacKeller, 2009)) and others are open to anyone willing to pay. Roughly a third of these are governed by MFIs, a third by NGOs and the rest by either community-based organisations or health care providers (ILO, 2006).

The most striking aspect of experience of these schemes is the willingness of those in informal employment to save and buy insurance. If schemes are designed with informal workers’ needs in mind and incorporate a level of flexibility, large numbers of informal workers can be incorporated into private contributory social protection schemes. This is true even for those at very low levels of income. The main problem in relation to micro-schemes relates to the high contribution to personal income ratio faced by those who choose to

8 Often, informal workers have to rely on informal savings mechanisms as a substitute.

contribute to these systems (ILO, 2004). An additional issue is that, generally speaking, only very large institutions (such as Grameen Bank and UTI) have been successful in providing micro-pensions. Many smaller institutions have had a short life span and failed early in their attempts to provide individual-level insurance to informal workers (ILO, 2004).

2.7 Community-based systems

In the absence of formal social security mechanisms, community-based mechanisms could act as a substitute to address uncovered social protection needs. The term ‘community-based system’ can be slightly misleading in that these schemes tend to be those that are limited to a particular geographical area where large numbers of poor people live as opposed to a collective community-driven initiative. The strength of these arrangements is that they allow individuals to pool risk in group insurance schemes while lowering administration costs. However, since they rely on co-insurance among the poor themselves they have had limited success. While a large number of community-based systems can be found, few of these have been successful enough to have met the insurance needs of most of those in the informal economy. Most examples of community-based social protection systems reaching any sizeable proportions of informal workers have been group insurance schemes aimed exclusively at addressing health care needs. This is unsurprising given the priority that many informal workers assign to health needs. These schemes tend to take the form of mutual health insurance schemes and examples can be found in a variety of countries in Latin America, West Africa and Asia.

Colombia and Bolivia both have community-based schemes to address the health care needs of those left uncovered by other schemes available in the country (Thomas, 2002). Colombia’s takes the form of a mutual benefit society to deal with the health care needs of the urban poor and covers four main areas: preventative care, out-patient care, hospital treatment and medicines. Members pay contributions into the system and participate in the management of the society. However, while it is partly contributory, the society depends on additional contributions and subsidies from various development agencies. The system provided benefits to just under 20,000 people in 1999. Bolivia’s system takes the form of a mutual health insurance system. The scheme is open to the public and around half of the members are those who have been excluded from other health schemes. The scheme covers basic health care services and members pay a contribution to the system. Like the Colombian system, the scheme in Bolivia also relies on subsidisation by donors (Thomas, 2002). The Bolivian scheme is limited in reach though, and in 1999 was only covering around 2,000 people (Thomas, 2002).

These funds tend to be limited in terms of the scale that they can achieve. Often, they are best conceived as a ‘gap-filler’ rather than as playing a large coverage role for informal workers. Attempts have, however, been made to scale up smaller community initiatives to a national scale. Rwanda has recently attempted to increase access to health care through an expansion of community health initiatives (Saksena et al., 2010). The government focused on supporting start-up initiatives in mutual health insurance and by 2003 coverage had reached 27% of the population. From 2005, external funding was added to strengthen the system and by 2007 around 74% of the population were covered with some form of health insurance. While the successful increase of insurance coverage shows the potential that scaling up of community initiatives has, the scheme has relied heavily on government and donor subsidisation. Also, the levels of benefit currently offered by the system fall short of the needs of those insured (Saksena et al., 2010).

In conclusion, while some examples of success have been found in the area of community-based initiatives, these tend to be restricted to selected contingencies (usually health care) and the level of benefits they offer are often low. They tend to rely heavily on donor subsidisation and have limited capacity for financial risk pooling, which leads to questions about their sustainability. Their coverage is also limited, with many health insurance schemes reaching less than 30% of their targeted population (World Bank, 2003). They may offer some potential as an initial stepping stone from which to build a more inclusive and comprehensive national system, but sustained success in this area has not yet been demonstrated.

2.8 Conclusions

While a variety of attempts have been made to provide those in informal work with social protection benefits, challenges remain and coverage for those in informal employment remains low. The various forms of attempted inclusion do, however, offer some valuable lessons for countries attempting to include informal workers in social protection systems.

Social assistance programmes can achieve a high level of coverage in terms of basic income protection. They offer a minimum level of protection for the most vulnerable members of society, including many of those working in the informal economy. However, they are not targeted specifically at informal economy workers and may even exclude many informal workers if they are means-tested. Their reliance on funding from tax revenues means that they can come at a high fiscal cost, particularly in countries with large informal economies. At best, they can offer an initial tier of social protection for some workers operating in the informal economy. However, in isolation they are inadequate as they do not offer the levels of protection required by most informal workers.

Social insurance systems can be successful in including informal workers, but much of their success depends on the design of the system. Mandatory participation has seen only limited success in extending coverage, while voluntary incentivised participation appears to offer much more potential. The key determinant of successful expansion is the creation of a scheme adjusted to the needs and circumstances of those operating in the informal economy. Successful systems have been flexible in relation to contributions (both in terms of the amount paid in and when the contributions are expected to be made), have allowed withdrawals under special circumstances, have offered subsidisation of contributions and have packaged a number of benefits into one system. They have also ensured that the system is as accessible as possible for those in the informal economy, often by using existing infrastructure (including existing grant systems) or by increasing access to bank accounts, and have provided education on pension systems as well as information on specific schemes.

Occupational schemes have achieved some level of success in a few countries and offer some potential for expansion. Most notable has been the experience of welfare funds in India. The major advantage of welfare funds lies in the way in which they reduce the financial costs associated with provision of social protection for both the government and for individuals by financing benefits out of dedicated taxes levied on the industry or occupational group. However, there are limits to the number of welfare funds that can be created and some occupational groups may be impossible to cover with this type of a scheme. Agriculture workers are frequently covered by entirely separate schemes in both developed and developing countries.

Individual-level insurance schemes have seen some success in extending social protection coverage in the form of micro-pensions. The successful experiences of several large MFIs offering micro-pension products have indicated the high levels of willingness shown by informal workers (even those at low incomes) to pay into pension systems when these systems are designed in a way that understands the needs and circumstances of informal workers (e.g. the need for flexibility in contributions). The major limitation of these schemes relates to the relatively high level of contributions that participants have to make in relation to their income levels.

Community-based schemes have shown only limited success in expansion of coverage and, even then, this has only been in the area of health care. These schemes have relied heavily on donor funding and tend to offer limited benefits. They might, however, have the potential to act as a platform from which to expand coverage in national social insurance systems in some circumstances.

3 Informal workers: definitions, approaches and recent trends

3.1 Approaches to informality

The concept of 'informality' itself has undergone a series of changes since it was first conceptualised as the 'traditional sector' in the 1950s and then defined as the 'informal sector' in the 1970s. The concept of informality has expanded further over time to come to include forms of informal or 'unprotected' employment in formal enterprises (leading to the broader concept of the 'informal economy', to be distinguished from the narrower 'informal sector'). In addition to shifting views about the boundaries of the informal, there have also been different approaches to the origins, significance and policy implications of informality. Different approaches give alternative interpretations as to why the informal economy exists, the ways in which it interacts with the 'formal sector', and its potential for future growth. Viewed in isolation, each gives an incomplete account of what 'informality' constitutes in reality. Incorporating aspects from each approach allows us to gain a more holistic understanding of informality and allows us to appreciate its complexity and nuances.

3.1.1 Dualist approaches

In the 1950s, the concept of a 'traditional sector' came into being. The sector was seen as being disconnected from modern capitalist modes of production and consisting predominantly of survivalist activities such as petty trade and small production (Chen et al., 2002). This concept formed the basis of Arthur Lewis's influential model of economic development. In this model, Lewis assumed that, as economies developed, surplus labour from the 'traditional sector' would be absorbed into modern industrial sectors (i.e. the 'formal sector') and ultimately eliminate the 'traditional sector'. Instead, the opposite has in fact occurred. Many economies in transitional stages of development have seen their 'traditional sectors' expand – so much so that the informal sector has come to be characterised as an inherent part of the development process.

In the 1970s, the term 'informal sector' was coined for the first time by Keith Hart, based on his observations of employment activities in Ghana. The term was intended to describe the subsistence activities of the urban poor in Accra. An ILO mission in Kenya that was sent to investigate employment in the country then expanded the concept. The report that emerged from this mission in 1972 has had a lasting influence on the way in which the informal sector has been conceptualised internationally. According to the ILO, the 'informal sector' was described as a 'way of doing things' characterised by a number of traits, including: ease of entry, reliance on indigenous resources, family ownership of enterprises, small scale of operations, labour-intensive and adapted technology, and skills acquired outside of formal school systems, as well as unregulated and competitive markets (Valodia, 2006). Unlike the 'traditional sector' concept, which was restricted to marginally productive activities, the ILO concept was inclusive of a broader range of economic activities, including those that were profitable and efficient, as long as they were characterised by the abovementioned traits (Chen et al., 2002). However, the concept was still marginal in that the 'informal sector' was seen as one providing incomes for those unable to link into employment opportunities in the formal economy.

3.1.2 Structuralist approaches

Portes and Moser first put structuralist interpretations of the informal sector forward. While structuralist interpretations were also dualistic to an extent (in terms of seeing the economy as comprised of two separate segments), they placed the informal sector within the context of the wider economy and thus introduced a level of interconnectedness between the formal and informal sectors for the first time. Taking a Marxist approach, the informal sector was seen as a 'set of subordinated economic units that serve to reduce the input and labour costs of the large formal enterprises' (Valodia, 2006) and hence formed an integral part of the process of capital accumulation. The informal sector was viewed as being born of a response to the formal sector's inability to absorb the mass of unemployed, i.e. a response to a crisis in the capitalist mode of production. 'Informality' in this interpretation was seen as a social and historical process rather than simply a separate 'sector' (Fakude, 2000:9).

3.1.3 Legalist approaches

The legalist interpretation of the informal sector was popularised by the work done by De Soto in Peru, where he investigated the difficulties firms in Peru faced in operating as legal enterprises. Due to the sheer complexity and cost associated with operating legally in the country, many firms actively *chose* to operate outside of the formal legal sector of the economy in order to reduce their costs of conforming to regulations. Once again, this was a dualistic interpretation of the 'informal sector'. However, the interpretation was slightly different from those outlined in earlier periods in that the 'informal sector' was defined primarily in relation to the state. To a certain extent, it was a neo-liberal interpretation in that the development of the informal sector was seen as a response in the form of deregulation from below.

Legalist interpretations of informality take an enterprise-based approach to defining informality and consider enterprises as informal if they are not legally registered and hence remain unregulated by the state. Recent developments in the informality of labour relations (to be outlined next) can also be interpreted in a 'legalist' manner: in an attempt to evade labour regulations (including social protection provisions), many firms are resorting to 'informalisation' of their labour forces.

3.2 Informal labour within formal enterprises – new international trends

Contrary to the expectations of some, the informal sector has persisted and expanded in many countries. 'Informality' in employment relationships has become *more* rather than less prominent in both developing and developed countries over time (Chen et al., 2002). The last couple of decades in particular have seen an international trend toward more insecure and informal forms of employment. While a variety of factors is driving these developments, one of the major drivers behind increased informalisation of labour relations *within formal enterprises* has been an economic response to the changing structure of the global economy (see Box 3.1). These dynamics correspond to Portes' view of informality (i.e. an economic response to crisis). However, rather than the response coming primarily from a marginalised sector (i.e. a bottom-up process), the response has been driven by large, formalised firms outsourcing and sub-contracting production activities.

Firms respond either through labour *casualisation* (increased use of casual, temporary or part-time workers) or *externalisation* (contracting labour out to other firms) (see Theron, 2000; Devey et al, 2004). In the former response, an employment relationship is maintained, albeit with fewer benefits (i.e. a loss of security such as no pension contributions). The latter response represents a more dramatic change in that the firm moves away from an employment relationship with its workers to a commercial contract with a sub-contractor, effectively removing most of a firm's labour security responsibilities. The sectors experiencing the highest levels of competition (such as manufacturing and textiles) are responding with the greatest degree of informalisation in work contracts.

Box 3.1 Global forms of flexible specialisation

Since the 1990s, increasing global economic integration (i.e. the lowering of trade and investment barriers, increased economic interdependence and the dispersion of production across the world) has changed the economic context in which firms operate. International competition has intensified, with firms responding by instituting new global forms of flexible specialisation in an attempt to lower their labour costs. Increasingly, firms are outsourcing parts of their value chain/productive processes either to developing countries with lower labour cost and less stringent labour regulations or have larger parts of their work being carried out by sub-contracted, temporary, seasonal or part-time labour (Pillay et al, 2004:7). Sometimes these take place simultaneously – through outsourcing to another country while simultaneously sub-contracting labour. This has accelerated new guises of informal labour relationships. Similar to the rationale presented by the structuralists, these developments represent a response to economic 'crisis'. However, in contrast to their viewpoint, these dynamics represent a lack of *willingness* rather than a lack of *ability* on the part of the formal 'sector' to absorb excess labour into formal systems (Chen et al., 2002).

Atypical forms of labour are on the rise and may become the norm rather than the exception. As these employment relationships are as insecure and unprotected as work traditionally classified as 'informal employment', it is important that they are included in modern thinking of what constitutes 'informality'.

3.3 Enterprise-based versus worker-based definitions

As the concept has evolved, so too has the official definition used for national statistical measurements of 'informality'. Over time, the definition has become more inclusive and incorporated broader aspects of informal employment.

The 15th International Conference of Labour Statisticians (ICLS) in 1993 adopted an 'informal sector' definition whereby individuals were defined as working in the informal sector according to the characteristics of the *enterprise* in which they worked. These enterprises were considered 'informal' if either (1) the enterprise was not registered according to national tax or commercial legislation or (2) the employees of the enterprise were not registered according to national tax legislation (Devey et al, 2004).

The 1993 ICLS definition took an enterprise-based approach to informality and did not fully capture its complexities and evolving dynamics. In particular, it could not capture the growth in informal work arrangements that increasingly existed even within fully formal enterprises. This problem was addressed by moving from an *enterprise-based* to an *employment-based* definition at the 17th ICLS in 2003. Instead of focusing on the formality of the enterprise, an employment-based definition defines informality in relation to the employment characteristics of the individual. According to this approach, individuals are considered to be in informal employment if their employment relationship is, in law or in practice, not subject to national labour legislation, income taxation, social protection or entitlement to certain employment benefits (advance notice of dismissal, severance pay, paid annual or sick leave, etc.).

This has consequently led to the concept of an informal economy, which is broader in that it captures both those originally defined by the enterprise-based definition (i.e. the informal sector) as well as new and emerging forms of informal work arrangements (i.e. those in informal employment).

An employment-based definition of informality is therefore more useful for our purposes as it captures all forms of informal employment, including newer trends in informality. It is also useful because it is defined in relation to the area of interest in this study, i.e. social protection.

3.4 Moving from dualism to a continuum of informality and formality

Largely, governments today still approach the question of informality in a dualist manner. This 'misplaced dualism' is problematic in that it does not capture three important realities: the existence of varying *degrees of informality* in employment relations, the *heterogeneity* that this implies, and the *linkages* that exist between those engaging in formal and informal activities. Understanding informality in a way that captures reality more accurately requires a movement away from a **dualist interpretation** of a 'core' and 'periphery' toward a **continuum** of informality. This however, makes policy prescriptions more complicated.

3.4.1 Degrees of informality

Formality and informality are more accurately conceptualised as opposite ends on a continuum with many intermediate cases existing between these ends (Devey et al, 2006:5). Figure 3.1 and Figure 3.2 below provide a simplified outline of this continuum concept.

Figure 3.1 The formality/informality contium

Figure 3.2 Categorising informality

Production units	Types of jobs	
	Formal employment	**Informal employment**
Formal enterprises	1	2
Informal enterprises	**3**	**4**

On one end of the continuum (the left-hand side of Figure 3.1, we have employment that is entirely 'formal', i.e. regulated and secure. These would be typified by jobs in formal enterprises that abide by all labour regulations. These jobs would have full employment contracts and include a variety of benefits such as paid leave, notice prior to dismissal, and retirement contributions. In Figure 3.2, this is represented by cell 1 (i.e. formal employment in a formal enterprise). On the other end of the continuum (the right-hand side of Figure 3.1), we have employment that is entirely 'informal', i.e. unregulated and insecure. Such employment would be typified by that originally conceptualised as the 'traditional sector' (e.g. small-scale survivalist activities along the lines of street trading). In Figure 3.2, this is represented by cell 4 (i.e. informal employment in an informal enterprise).

Between these two poles exists a multitude of work arrangements that incorporate various degrees of formality and informality according to how secure and regulated work arrangements are. While Figure 3.1 and Figure 3.2 simplify reality, we get a sense of the increasing informality of employment at various points as we move along the continuum. Points 1 and 2 on the continuum both represent employment in formal enterprises, but point 2 represents a greater degree of informality as the job itself is ‘informal’ even though it is located within a formal enterprise. This would include those forms of ‘casualised’ or ‘externalised’ labour outlined earlier, which have a higher degree of insecurity than jobs located at point 1. As we move from point 2 to point 3, we encounter an even greater degree of informality. Point 3 represents jobs where the employment relationship is ‘formal’ (i.e. it includes a written contract with the employer) but the job itself is situated in an informal enterprise. As the enterprise itself is informal, the employment incorporates a greater degree of informality and insecurity than point 2 because even if a written contract with benefits exists for the job, the contract cannot be enforced or governed by existing labour regulation as the enterprise falls outside of the reach of the state (due to non-registration of the enterprise). Moving from point 3 to point 4 represents even greater degrees of informality and insecurity, as the job type itself becomes ‘informal’.

Enterprise-based definitions of informality capture only cells 3 and 4 of Figure 3.2, but employment-based definitions also capture cell 2. Informal employment is therefore made up of employment arrangements characterised by all but cell 1 in the table.

3.4.2 Heterogeneity

Introducing the concept of continuity is helpful in that it highlights the **heterogeneity** of the informal sector. Informality includes not only those activities situated at point 4 on the continuum but also incorporates a whole host of work arrangements with a variety of characteristics that differ according to where they are situated on the continuum. Informal employment incorporates a variety of *employment relations* (e.g. unpaid family workers or disguised wage workers at point 4 and sub-contracted or temporary staff at point 2). The factors driving the *existence* of the various forms of informality differ at different points along the continuum (e.g. survivalist motivations are typical at point 4 while avoidance of labour regulations is typical at point 2). Informal employment also includes activities that have varying degrees of *economic potential* (from survivalist enterprises at point 4 to successful small enterprises at point 3 all the way up to large formal enterprises at point 2) (Devey et al, 2006). Various types of *economic activity* exist at all points along the continuum (e.g. trading, collecting, manufacturing, providing services, etc.).

3.4.3 Dynamic linkages between the formal and informal sector

Dualist interpretations of informality could not explain an important reality of informal activities – that of a dynamic interconnectedness between formal and informal activities. Rather than operating as structurally disconnected ‘economies’ with separate suppliers, customers, inputs and labour markets, formal and informal activities are often linked in a variety of ways.

As the ILO (2002:12) states:

- ‘Many informal enterprises have production or distribution relations with formal enterprises: supplying inputs, finished goods or services to each other either through direct transactions or sub-contracting relations, and
- ‘Many formal enterprises hire wage workers under informal employment relations: many part-time workers, temporary workers, and industrial out-workers work for formal enterprises through contracting or sub-contracting arrangements’.

At all points along the informality continuum, linkages to ‘fully formal’ activities exist. Even at point 4 (i.e. the most informal arrangement of employment), it is the norm to find backward and forward linkages to activities at the formal area of the continuum.

3.5 Key aspects

Key aspects of the current understanding of informal work are that:

- People enter informal employment *for different reasons* – it may because of a lack of access to formal opportunities or it may be to avoid regulations that make running a business too costly or difficult.
- Informal employment involves a *wide range of activities* (trading, manufacturing, services, etc.) and can be *found in most industries* (agriculture, construction, finance, etc.).
- Informal employment involves activities with *wide variation in terms of their economic potential* – some activities are marginal and unlikely to provide much more than basic survival for the individuals involved in them, others are more dynamic and efficient and have a greater potential for growth, and still others involve large, technologically sophisticated firms making use of informalised labour.
- Formality and informality are better viewed as *operating on a continuum* – employment can be more or less 'formal' depending on how regulated and secure the employment is.
- *Informal activities interact with formal activities* in a variety of ways – there are numerous backward and forward linkages to each other and sometimes the same individual is employed simultaneously in a formal and in an informal job.
- Despite the heterogeneity of the sector, there is one characteristic that all forms of informal employment have in common – the lack of formal mechanisms of social protection inherent to these forms of employment as well as the inherent insecurity that this implies for the individual. This is the common denominator underlying informality in employment and is of major significance for the purposes of this study.

3.6 Characteristics of informal work in South Africa

3.6.1 Informal work in South Africa: a global comparison

Notwithstanding the difficulty in collecting accurate statistics on informal employment, some basic facts can be outlined relating to the size and nature of informality across the globe. That said, due to the differences in conditions in different countries and the different approaches to measurement in different places, there have been few recent attempts to produce internationally comparable data on the informal economy.

Informal employment makes up a significant proportion of all employment in developing countries. Informal employment in developing regions ranges from 25% to 90% of total employment (ILO, 2014). The respective percentages differ by region, as can be seen in Table 3.1.

Table 3.1 Comparative views on size of informal employment

Developing region	Informal employment as a percentage of total non-agricultural employment (minimum and upper estimates)
Latin America	30%–70%
Asia and the Pacific	30%–70%
Middle East	20%–24%
Africa	25%–65%
South Africa	**33%**

Source: Global Employment Trends (ILO 2014:24)

These figures are even higher if agricultural employment is included in total employment. For instance, at a country level informal employment makes up 83% of India's total *non-agricultural* employment but 93% of *total* employment (ILO 2002). Informal employment in transition countries is not as significant as it is in developing regions, but its proportionate size has been increasing. Even in developed regions, employment relationships that tend to sit toward the 'informal' end of the continuum (such as self-employment, part-time work and temporary work – all called non-standard or atypical work) make up fairly significant proportions of the labour force. For example, in 15 European countries they make up 30% and in the US 25% of overall employment (ILO, 2002).

In almost all developing regions, informal *self-employment* makes up a greater percentage than that of informal *waged employment*. In sub-Saharan Africa, self-employment plays a significant role, making up around 80% of total non-agricultural informal employment. Table 3.2 indicates the percentage that informal self-employment makes up of total non-agricultural formal employment in a variety of developing regions.

Table 3.2 Self-employment as a proportion of informal employment, 2002

Developing region	Informal self-employment as a percentage of total informal employment
North Africa	62%
Latin America	60%
Asia	59%
Sub-Saharan Africa	70%
Sub-Saharan Africa (excluding South Africa)	80%
South Africa	**40% (Wills (2009) for 2005)**

Source: ILO 2002

Two of the largest sub-groups of informal workers – *home-based workers* and *street vendors* – make up roughly 10% to 25% of the non-agricultural workforce in developing regions. While street vendors are the more visible of the two groups, home-based workers tend to be more numerous. Even in developed regions, the two groups combined make up around 5% of the total workforce (ILO, 2002).

Working females in developing countries are more likely to be employed in the informal sector than the formal sector once outliers such as North Africa (where 43% of women are in informal employment) are removed. The norm is for the majority of women's employment to be based in informal employment, often with 60% or more of the female labour force being comprised of those in informal forms of employment (ILO, 2002). The regional variations are shown in Table 3.3. Of those women engaged in informal self-employment, most are own-account workers (i.e. single business operators or heads of family businesses) or unpaid family contributors (Chen, 2008).

Table 3.3 Proportion of employed women in informal employment

Developing region	Women in informal employment as a percentage of total female employment
North Africa	43%
Latin America	58%
Sub-Saharan Africa	**84%**

Source: ILO 2002

3.6.2 Composition and trends of informal workers in South Africa from survey data – overview

In South Africa, the data used to estimate the size and characteristics of informal employment over time have come predominantly from the October Household Survey (1995–1999), the Labour Force Survey (LFS 2000–2007) and the Quarterly Labour Force Survey (QLFS 2008–2013). Budlender (2010) recently provided a review of the shifts and discontinuities involved in moving from the LFS to the QLFS and others have dealt with comparison between the different surveys (e.g. Muller, 2002).

South Africa's informal sector has traditionally been considered an outlier in the region for two key reasons:[9]

- Informal employment makes up a much *smaller percentage* of total employment than in most developing countries (particularly considering the high levels of unemployment in South Africa); and
- Informal *waged employment*, rather than informal *self-employment*, makes up the majority of informal employment in the country.

These characteristics are partly due to the historical and political context of the country, which limited the growth of informal activities prior to the mid-1990s. However, they are also partly explained by definitional and measurement issues that led to an initial underestimation of the size of informal employment when first measured in the mid-1990s. The accuracy of measurements of informal employment in South Africa have improved considerably since then, and recent surveys suggest that informal employment is more prevalent than previously assumed. Although South Africa's outlier characteristics are not as dramatic as was thought, however, the size and composition of informal employment nevertheless continue to differ from those of the rest of the African region.

A country's historical and political context plays an important role in determining the development, characteristics and trajectory of the informal economy (Valodia, 2006). South Africa's history of legislation restricting business activities among the black population undoubtedly reduced the extent of informal activities in the country. These restrictions, while particularly harsh during the Apartheid era, started long before the Apartheid system was officially institutionalised. As early as the late 1800s, the black population was denied access to means of production. Entrepreneurial activities among the black population were consistently repressed and strict limits were placed on the types of work that black people could do. For those few areas in which they could legally operate, black businesses had to obtain a municipal licence as well as permission from the Labour Minister every year in order to operate their business. Operating informally was incredibly difficult. 'Move-on laws' were put in place in order to force street hawkers to move their site of trading every half hour (Lund, 1998), and the spaces in which informal enterprises operated were periodically cleared by the police (Kingdon and Knight, 2001).

9 Hence the large change in regional percentages for sub-Saharan Africa when South Africa's statistics are removed from the regional statistics, as was outlined earlier.

While restrictions were slowly lifted from around the mid-1980s, many licensing controls and restrictive by-laws lingered for some time after, effectively constraining the growth of the informal sector until well after the system of Apartheid was officially abandoned. The history of economic disempowerment had lasting implications for the potential size and growth of the informal sector, in that this inhibited the development of entrepreneurial skills and social capital among the black population (Kingdon and Knight, 2001). Highly skewed development between 'white areas' and 'black areas' left a lasting legacy of inequality in the country. Consequently, the formal sector tends to dominate (making up 60% of employment (Chen, 2008)) and continues to constrain informal employment opportunities even in the absence of restrictions on economic activity.

The history of repression and restrictions on business activity for the bulk of the population ultimately led to a smaller than average informal sector, as well as to fewer self-employment activities than would be expected in other countries at a similar stage of development.

3.6.3 Broad labour market trends

In 2013, South Africa had a population aged 15+ which was just over 36 million. Close to 17.5 million people of working age were not economically active, about 14 million were employed and 4.7 million unemployed, providing an official (or narrow) unemployment rate of 25.4% (see Table 3.4).

An important context for the analysis of the South African informal economy is continuing high levels of unemployment. Leibbrandt et al. (2010) (using a variety of surveys) show narrowly defined unemployment (excluding discouraged work seekers) rising from 13.6% in 1993 to 28.9% in 2001 and then starting to fall back to around 23% in 2008. Since then unemployment has again risen to around 25%.

Unemployment is particularly high among the 16–24 year age group, reaching 39.4% in 2008, with the rate for 25–54 year olds at 21.5% (Leibbrandt et al., 2010a). Unemployment among women is significantly higher than that of males. In quarter 2 of 2013 Stats SA measured the unemployment rate for women at 28.3% compared to 23.4% for men. A large proportion of unemployment is long term, with Stats SA estimating the proportion in Q2 of 2013 who have been unemployed for longer than a year at 66.6% (Stats SA, 2013).

Table 3.4 South African labour market trends, 2005–2013[10]

Category	2005	2006	2007	2008	2009	2010	2011	2012	2013
Employed	12,500,775	12,964,284	12,970,435	13,892,989	13,507,286	12,907,267	13,252,273	13,582,902	13,879,252
Unemployed	4,633,487	4,532,922	4,066,904	4,132,085	4,132,531	4,318,438	4,547,922	4,473,846	4,730,558
Not economically active	13,628,999	13,632,188	14,010,835	14,929,958	15,768,034	16,573,682	17,185,003	17,482,796	17,468,118
Total pop. 15+	30,763,261	31,129,394	31,048,174	32,955,032	33,407,851	33,799,387	34,985,198	35,539,544	36,077,928
Unemployment rate	27.0%	25.9%	23.9%	22.9%	23.4%	25.1%	25.5%	24.8%	25.4%

Source: Wills (2009) for 2005 to 2007 and own calculations from QLFS (quarter 2) from 2008 to 2013

Clearly then, the informal economy has failed to absorb surplus labour over the last two decades. Key factors behind the rise in unemployment to around 2002 as identified by analysts are: strong increases in labour force participation, sluggish economic growth, and an 'inflexible labour market' (Leibbrandt et al., 2010a, following Kingdon and Knight, 2008). The reduction in unemployment up to 2008 has been attributed to higher economic growth and lower population and labour force growth (Leibbrandt et al., 2010a).

10 Wills (2009) calculates the labour market trends using individuals older than 15 years old. Stats SA uses individuals between the ages of 15 and 64. OPM includes the 15 year-olds like Stats SA but does not set an upper bound because informal workers do not have a set retirement age.

While unemployment declined steadily between 2005 and 2008, recent data show that, since 2008, in the context of the world economic recession unemployment has risen again, remaining at around 25% since 2010 (see Table 3.4)

3.6.4 Trends in informal employment

Estimates of the size of the informal economy in South Africa have varied significantly, sometimes based on ideological conviction (see Van Der Berg, 1990) but more recently because of shifting definitions and the availability of improved data.

In 1990 Van der Berg, based on a survey of informal sector activity, estimated the size of the informal sector (including full-time and part-time workers and excluding whites) at around 2.7 million people and as 29.3% of the economically active population. A variety of other estimates came available during the 1990s and early 2000s as, first, the October Household Surveys became institutionalised and, second, after 2000 the LFSs from Stats SA began (see Barker, 1995; Budlender et al., 2001; Muller, 2003).

Analysts have identified broadly two phases with regard to the development of informal employment in South Africa since the mid-1990s:

- From the mid-1990s to the early 2000s there was a period of rapid growth in the size of informal employment, both self-employment and waged employment (Wills, 2009; Casale et al., 2004); and
- Since the early 2000s there has, on some evidence, been a stabilisation in the size of informal employment, while other evidence points to an absolute and relative decline in informal employment (Valodia, 2007; Heintz and Posel, 2008).

While some of the apparent growth in informal employment during the first phase may have been due to improving surveys and data, a number of factors provide sound explanations for the growth in informal employment in the period after the coming of democracy:

- Restrictions on African business were removed post 1994;
- Policies were put in place to encourage the growth of small, medium and micro-enterprises;
- Growth in formal employment was mostly stagnant and could not absorb the increased labour supply; and
- Formal enterprises across a number of industries resorted to increased outsourcing and sub-contracting in response to competitive pressures brought about by trade liberalisation, creating more informal forms of labour relations in the country.

Table 3.5 provides estimates of the size of the informal sector using both an enterprise-based definition (i.e Valodia et al, 2007) and a definition focused on characteristics of employment (with formal employment defined by the presence of an employment contract or both paid leave and pension contributions, following Budlender et al (2001). This latter is often referred to as the WIEGO definition). The estimates first show that in terms of an enterprise definition there is no clear trend over time, with total informal employment hovering below 3 million for most of the period (and somewhat below 30% of total employment), with the 3 million level only broken (somewhat inexplicably) in 2005.

Table 3.5 Measurement of the informal sector and informal employment, 2000–2005

Informal employment			2000	2001	2002	2003	2004	2005
Enterprise-based definition								
Valodia 2007	Includes Agriculture	Number	4,100,426	3,280,277	3,220,958	3,377,896	3,360,582	3,802,412
		Percentage of employed	35.19	30.13	28.96	28.78	28.63	30.49
	Excludes Agriculture	Number	3,017,215	2,868,084	2,644,177	2,983,381	2,886,278	3,421,325
		Percentage of employed	30.53	29.28	27.20	28.43	27.16	29.76
Worker-based definition								
Wills 2009	Includes Agriculture	Number						4,463,188
		Percentage of employed						35.70
	Excludes Agriculture	Number						3,962,419
		Percentage of employed						33.77
Heintz and Posel 2008	Includes Agriculture	Number		4,789,000	4,498,000	3,935,000	4,059,000	
		Percentage of employed		43.16	39.79	34.74	34.84	

Enterprise definition: formal if enterprise registered; Worker-based definition: formal if self-employed and business registered and if employed with contract or both paid leave and pension. Calculations by respective authors based on Stats SA LFS.

Using the ‘characteristics’ definition provides a substantially higher estimate of informal employment than the enterprise definition – at least in the initial years of the comparison. While the gap is somewhat erratic, the numbers according to the characteristics definition exceed those using the enterprise definition by well over 1 million workers in 2000 and 2001 and by around 600,000 in the following years, showing the addition of informal workers in formal sector enterprises.

The definition focusing on nature of employment also shows a decline over time in the number of informal workers (Table 3.6), a trend that continued between 2005 and 2007 (Wills 2009). Although the trend is not consistently declining over the period 2008–2013, the percentage of informal workers is lower compared to the 2000–2008 period. In Q2 of 2013 informal employment (including the agriculture sector) was 3.8 million or 27.4% of the total employed. Informal workers (including the agricultural sector) totalled 3.6 million in 2013, or 27.2% of all employed people outside the agricultural sector.

Table 3.6 Measurement of informal employment, 2005–2013

Informal employment		2005	2006	2007	2008	2009	2010	2011	2012	2013
Worker-based definition										
Wills 2009	Includes Agriculture	4,463,188	4,589,846	4,184,200						
	Percentage of Employed	35.7	35.4	32.3						
	Excludes Agriculture	3,962,419	3,939,465	3,649,459						
	Percentage of Employed	33.77	32.85	30.14						
OPM	Includes Agriculture				4,399,759	3,843,083	3,801,391	3,712,729	3,644,239	3,801,403
	Percentage of Employed				31.7%	28.5%	29.5%	28.0%	26.8%	27.4%
	Excludes Agriculture				4,021,470	3,560,401	3,561,536	3,495,291	3,423,430	3,582,415
	Percentage of Employed				30.7%	27.8%	29.0%	27.6%	26.5%	27.2%

Worker-based definition: formal if self-employed and business registered and if employees with contracts have both paid leave and pension. Based on Wills 2009 and own calculations using QLFS.

Many studies have documented a growing casualisation of labour in South Africa.[11] Much of this has come in the form of sub-contracting of labour in a number of sectors, including food, farming, transport, construction, engineering, footwear and clothing (Devey, et al, 2004:32). This is particularly prevalent among large enterprises (ILO, 2002). Some sectors have particularly high levels of casual labour – for example, between 60% and 80% of the labour in the construction industry is in the form of casual labour. This is due to a restructuring of the construction industry in recent years, with new forms of labour-only sub-contracting being used in an industry that was already characterised by precarious and short-term work arrangements (ILO, 2003). While the retail sector has roughly 20% of its labour force in forms of casual labour, one study found that casual labour makes up 70% of the workforce in Woolworths, one of the largest retail outlets in the country (NEDLAC, 2006:4). The clothing and textiles industry has also experienced a high level of informalisation since trade liberalisation began to increase competitive pressures in the industry. Many former garment workers have been sub-contracted as home-workers, with the same level of income but with none of the employment benefits they used to receive (Pillay, et al 2004).

11 See, for example, Devey, Skinner and Valodia (2006), Heintz and Posel (2008), Pillay, Devey, Skinner and Valodia (2004), ILO (2003), Fakude (2000).

3.6.5 Degrees of formality and alternative definitions of informal work

Box 3.2 Labour externalisation in South Africa

Studies focusing on specific industries in South Africa have found a trend of increasing casualisation and externalisation of labour in the country (see, for example, Barrientos and Barrientos (2002) on horticulture, Goldman (2003b) on the construction industry, Barrientos and Kritzinger (2004) on fruit exports and Fakude (2000) on the clothing sector). While South Africa has a long history of flexibility in labour systems in the form of migrant and contract labour, the post-Apartheid era has seen new forms of non-standard employment emerge and in an increasing number of sectors.

While both casualised labour (i.e. the use of casual, temporary or part-time workers) and externalised labour (i.e. sub-contracting of work through commercial contracts) are used in South Africa, externalised labour seems to have been a more prevalent trend (Benjamin, 2008). South Africa has experienced two phases of labour externalisation since the mid-1990s, each taking on a different form in an attempt to evade labour legislation.

1. From around the mid-1990s until the early 2000s, many firms ‘restructured’ their workforces by ‘converting’ employees into **independent contractors**. This was predominantly done to take advantage of a loophole that existed in the Labour Relations Act (LRA) whereby *independent contractors* were excluded from being defined as employees in labour legislation. No substantive changes were made to the nature of the work carried out by staff. However, with employees re-classified as ‘independent contractors’ companies were no longer obliged to abide by the provisions of the LRA (including regulations on minimum wages, contributions to pensions, UIF, medical aid, sick pay or holiday pay). Until around 2001, South Africa experienced a large increase in workforce restructuring of this kind, largely aided by an employers’ organisation called the Confederation of Employers of South Africa (COFESA) (Skinner and Valodia, 2004). In 2002, partly in response to the independent contracting trends, the loophole was closed through the inclusion of statutory presumptions of employment into both the LRA and the Basic Conditions of Employment Act.

2. New forms of labour externalisation have emerged since the loophole was closed. Since the early 2000s, firms have increasingly made use of **triangular employment relationships**. In triangular employment relationships employers enter into commercial contracts with temporary employment services or labour brokers and hire workers through them rather than hiring workers directly. The labour broker is responsible for providing workers to the client and is defined within labour legislation as the official employer of the worker. This allows firms to outsource labour regulation responsibilities to labour brokers. Workers enter into temporary employment contracts with the labour broker but supply their services to (i.e. carry out work for) the firm/client. In theory, both the labour broker and client are jointly responsible for adhering to the regulations of the Basic Conditions of Employment Act. Workers should therefore be entitled to the benefits contained within the Basic Conditions of Employment Act such as paid leave, sick leave, etc. However, labour-brokering is currently not effectively regulated and therefore workers are in reality often not protected by labour law as they are unable to enforce (and are sometimes unaware of) their rights. They are also paid significantly less than those employed directly by the client and have temporary contracts that can be terminated at short notice, meaning they experience high levels of insecurity in their employment relationships (Benjamin, 2008).

Two aspects of this informalisation process are important in relation to the aims of this study. Those employed under such circumstances would still have a *contract* in relation to their employment. However, they often lose (legally or illegally) the benefits that they would receive in standard forms of employment (pension, UIF contributions, medical aid, paid leave etc.) and hence are in unprotected and insecure forms of employment despite the existence of a written contract in their employment relationship.

There is thus a general perception that informal or unprotected work in South Africa is growing rapidly. Benjamin (2008), for example, concludes that ‘an increasing proportion of the South African workforce is employed in work that is effectively unprotected by labour legislation or any other law’. He relates this ‘informalisation’ to a number of factors, including ‘outsourcing, labour broking, shifting of risks to workers and strategies to avoid labour law’.

As is evident from the data in the previous section, this perceived growth in informal employment is not reflected in the numbers, which actually show a steady decline in informal work over most of the previous decade.

One explanation of this paradox is that offered by Heintz and Posel (2008), which attributes the data trend to an increasing number of all wage employees with contracts that are captured as a 'formalisation' of waged employment, and declining informal work. They describe the 'evidence of formalisation of waged employment in recent years' as 'surprising in light of the research which suggests the growing casualisation of employment in South Africa'.

As Heintz and Posel hint, this apparently contradictory evidence implies that the definition of formal as being in possession of a contract might not be an appropriate definition and base for measurement of informality.

Much of the more comprehensive statistical analysis of informality in South Africa has relied on the WIEGO approach in terms of classifying workers as formal or informal. While the classification of the self-employed according to registration or non-registration of the enterprise in which they employ themselves is a clear enough distinction of formality versus informality, a couple of problems arise when approaching the classification criteria used for wage employees.[12] These relate to the use of the 'written contract' criterion as a sufficient condition to indicate formality in an employment relationship. This is problematic for two reasons: 1) a written contract does not necessarily imply that labour regulations are abided by in the employment relationship; and 2) the contract criterion disguises the differing 'degrees of informality' that exist in employment relationships.

Referring back to the 17th ICLS in 2003, the employment-based approach to informality defined informality in relation to the employment characteristics of the individual. Specifically, informal employment refers to situations in which an individual's employment relationship is 'in law, or in practice, not subject to labour legislation, income taxation, social protection or entitlement to certain employment benefits' (Hussmans). In relation to the first problem mentioned above, the WIEGO approach seems to make the assumption that, if a written contract exists, then the employment relationship is likely to be subject to labour legislation and hence is regulated and secure or 'formal'.

In the literature a number of commentators have focused on degrees of informality, in essence concluding that a focus on simply one or two aspects of informality may be misleading and that there should be a focus on a range of factors and how they combine.

Budlender et al. (2001), for example, focused on three elements of informality: the existence of a written contract; whether the work is casual, seasonal or temporary; and the absence of paid leave. They compare domestic workers, informal and formal sector workers in terms of these three elements to provide a much more nuanced view of the reality of formality and informality (see Table 3.7). Alternative approaches to indices for informality are found in Lund and Ardington (2006) and Yu (2010).

12 Wage employees are classified as formal if *either* 1. they have a written contract *or* 2. paid leave *and* pension. If they do not fulfil either of these criteria, they are classified as informal.

Table 3.7 Employed population aged 15–64 by sector, status in employment and number of informal sector attributes (1,000)

	Employees by number of informal characteristics					Self-employed	Unpaid family	Unknown	Total
	0	1	2	3	Total	Total	Total	Total	
Domestic	62	187	392	356	997	1	0	1	999
Informal	89	113	233	444	879	1,910	108	1	2,898
Formal	3,825	1,653	862	641	6,982	486	40	1	7,509
Unknown	82	44	41	42	209	71	7	19	306
N/A	6	5	5	15	31	17	1	6	54
Total	4,064	2,004	1,533	1,498	9,097	2,486	156	28	11,767

Source: Budlender et al. (2001)

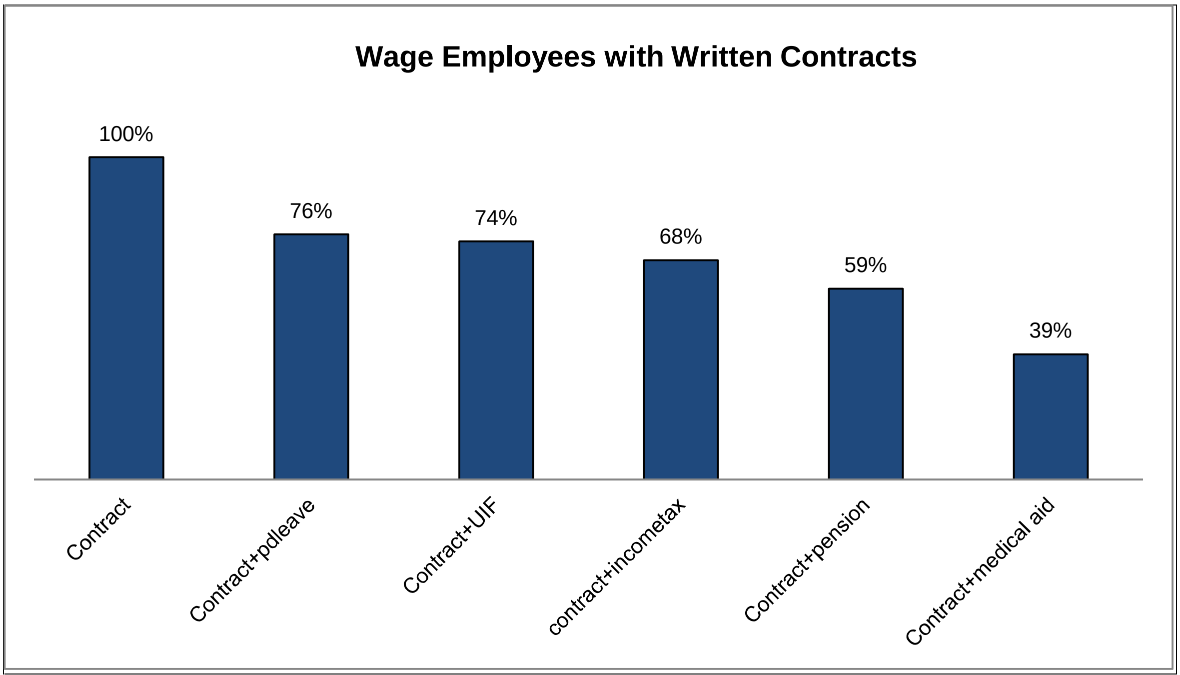
Data from the recent QLFS also indicates that a contract cannot be assumed to provide adequate security or a good indication of formal type work. In the QLFS, wage employees are asked about the following five criteria in relation to their employment relationship:

- whether their employer contributes toward a *pension* on their behalf;
- whether they are entitled to *paid leave*;
- whether their employer pays *UIF contributions* on their behalf;
- whether they are entitled to *medical aid* benefits from their employer; and
- whether their employer deducts *income tax* from their salary.

These criteria all represent characteristics that are related to more formal forms of employment relationships, i.e. the more 'yes' answers an employee gives, the more formal and regulated the employment relationship and, hence, the more secure the employment relationship is.

Figure 3.3 investigates each criterion individually. It outlines the proportion of wage employees with written contracts that answer in the affirmative to each of the five separate questions.

Figure 3.3 Categorising informality Percentage of wage employees with written contracts wth additional employment benefits (QLFS 2013.2)

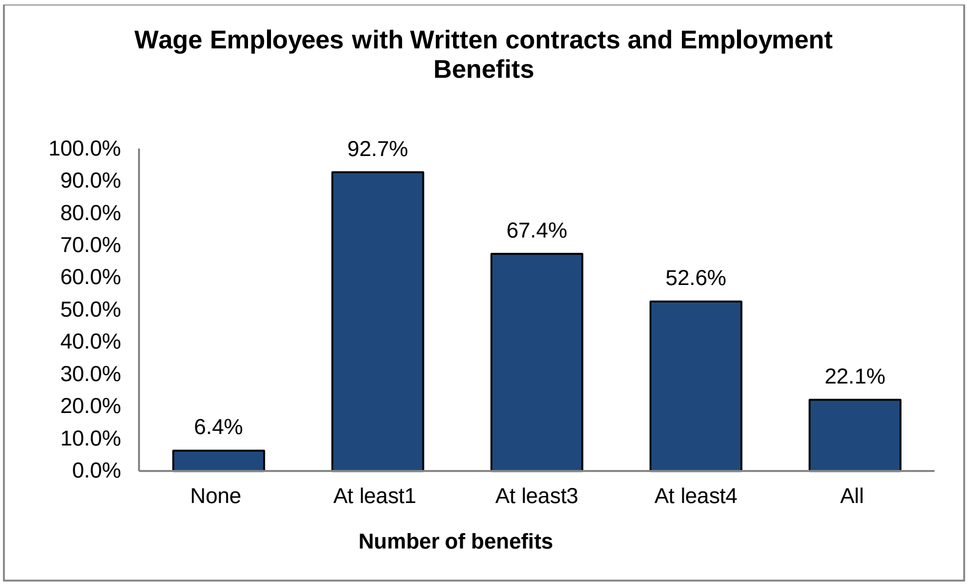


Source: Authors' calculations, QLFS 2013(2)

According to the data, we see some variation in the relation to the proportion of wage employees with contracts who answer in the affirmative to each of the individual criteria. Around 76% (the largest proportion) of wage employees with written contracts are entitled to paid leave, 74% have employers who make UIF contributions on their behalf, and 68% have income tax payments deducted from their salary. Only 59% of wage employees with contracts have employers who contribute toward a pension on their behalf and this proportion drops further to 39% for those with medical aid benefits.

This seems to suggest that having a written contract does not necessarily imply that an employment relationship is subject to labour regulations or that the employment necessarily includes all the benefits that those in formal permanent employment are expected to have. Figure 3.4 indicates the proportion of those with written contracts who answer in the affirmative to various combinations of the five criteria outlined above.

Figure 3.4 Percentage of wage employees with written contracts and employment benefits (QLFS 2013.2)



Source: Authors' calculations, QLFS 2013(2)

The first and last bar represent the two extremes in employment. The first indicates the percentage of wage employees with contracts who answer no to all five criteria, while the last bar represents the percentage who answer yes to all five criteria. Only 22.1% of those with written contracts have what would be considered fully formal (i.e. secure, protected and regulated) employment characteristics as they have a written contract, a pension, are entitled to paid leave, have UIF contributions made on their behalf, receive medical aid benefits, and have income tax deducted from their salary. At the other extreme, 6.4% of those with written contracts (who, according to the WIEGO classification, would be classified as formal by virtue of their contract status) meet *none* of these five criteria. This means that although they have a written contract they are not entitled to paid leave, do not receive a pension, do not have income tax deducted from their salary, do not have UIF payments made on their behalf and are not entitled to medical aid benefits. All of these characteristics would seem to suggest that, despite having a written contract, their employment situation is better classified as being that of informal employment as outlined by the 17th ICLS approach. In reality, their employment relationship does not abide by labour regulations and they are not entitled to employment benefits. Reclassifying these workers as informal would add around 600,000 additional workers to the informal economy (thus increasing the size of the total informal economy from 3.58 million to around 4.18 million and from 27.22% to around 31.78% of total non-agricultural employment).

In relation to the second problem, we can see in Figure 3.4 that various degrees of informality (i.e. employment relationships characterised by more or less of the five criteria) exist even for those with written contracts of employment. Of those with contracts, 52.6% have at least four out of the five criteria characterising their employment relationship (indicating a fairly high level of formality). This increases to 67.4% of those with written contracts when the less stringent condition of at least three criteria is used and then increases to 92.7% of those with contracts when looking at those who have at least one of the five criteria. As we move from more to fewer criteria, the total percentage increases. However, so too does the level of informality in the employment relationship. Those with fewer 'yes' answers to the five criteria exhibit fewer of the characteristics that tend to characterise fully formal (protected and secure) types of employment.

3.6.6 Waged employment vs. self-employment

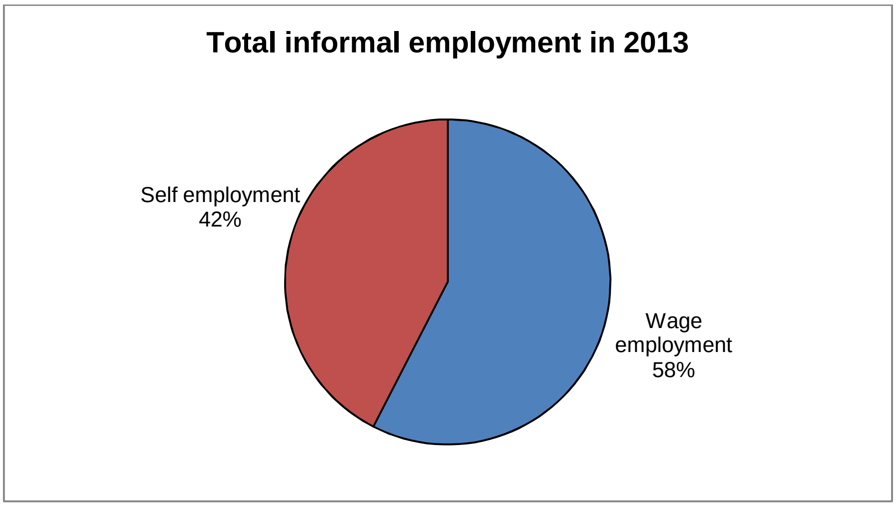
Of those in informal employment, the majority (58%) are informal wage employees and the remaining 42% are informally self-employed. This distribution has remained constant since 2005, while total numbers have been decreasing for both the self-employed and wage employees (with the exception of 2013, where the numbers of self-employed informal workers increased).

Table 3.8 Distribution of informal employment between wage and self-employment, 2005–2013

Total informal employment	2005		2007		2010		2013	
(in millions)	**Number**	**%**	**Number**	**%**	**Number**	**%**	**Number**	**%**
Waged employment	2.36	59.64	2.22	60.94	2.14	60.08	2.06	57.56
Self-employment	1.6	40.36	1.43	39.06	1.42	39.92	1.5	42.44
Total informal employment	**3.96**	**100**	**3.65**	**100**	**3.56**	**100**	**3.58**	**100**

Source: Wills (2009) and own calculations based on QLFS for 2010 and 2013

Figure 3.5 Distribution of informal employment between sel-employment and waged employment, 2013



Source: Authors' calculations, QLFS 2013.2

South Africa differs from most developing countries in that the informally self-employed make up a smaller proportion of those in informal employment than informal wage employees. However, total self-employment as a percentage of total employment[13] in South Africa is very small. In 2013, self-employment only contributed 15% to total employment. In Table 3.9, we can see that while there are lower *absolute* numbers of the informally self-employed than informal wage employees, because there are relatively few self-employed people in South Africa, informal self-employment makes up a significant amount of those who are self-employed. Those who are informally self-employed make up three-quarters (77%) of total self-employment.

13 Non-agricultural, formal and informal.

Table 3.9 Formal and informal non-agricultural employment, 2013

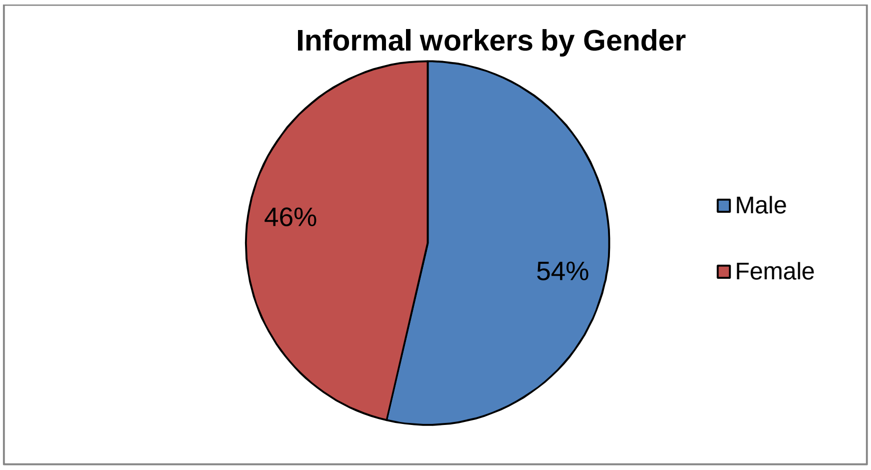
Non-agricultural employment	Formal	Informal
Wage employee		
Number	9,024,021	2,062,054
Percentage of wage employees	81.40	18.60
Self-employed		
Number	470,876	1,520,362
Percentage of self-employed	23.65	76.53
Total employment		
Number	9,494,897	3,582,415
Percentage of total employment	72.61	27.39

Source: Authors' calculations, QLFS 2013.2

3.6.7 Gender dimensions

Informal employment is roughly equally distributed across the genders (46% female and 54% male), but men make up a larger percentage of informal self-employment (59%) and women make up a larger percentage of informal waged employment (51%). While women in absolute numbers make up around half of the informal economy, as a share of total employment informal employment contributes to a much greater share of total employment for women in comparison to men.

Figure 3.6 Informal employment by gender, 2013

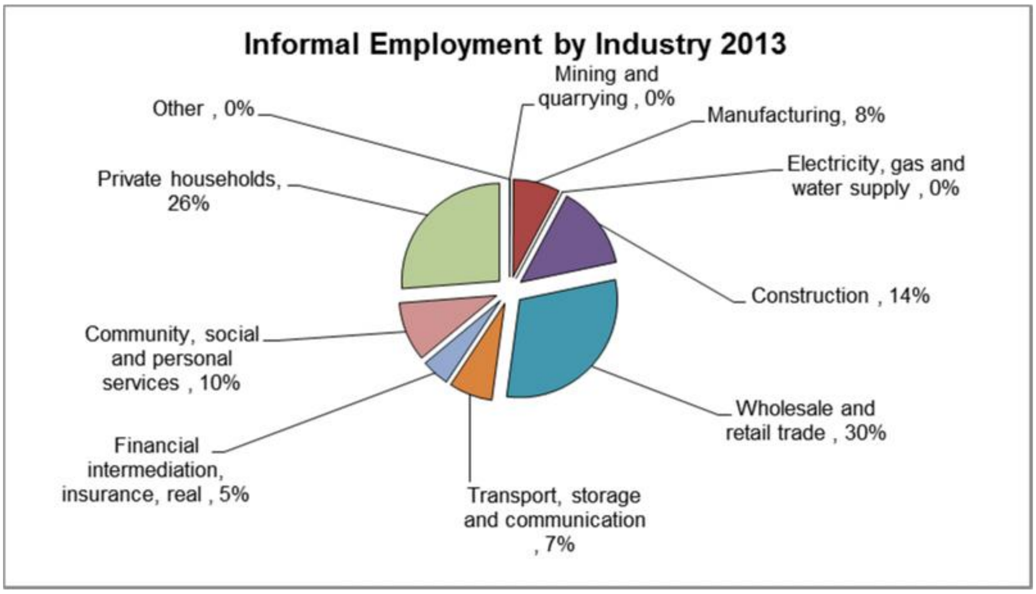


Source: Authors' calculations, QLFS 2013.2

3.6.8 Industry

Looking at the informal economy by industry, we find that two industries together make up the largest portion of the informal economy: wholesale and retail trade (30%) and private households (26%). Combined they contribute to 56% of informal employment. Of those in the wholesale and retail trade, a large proportion is made up of street vendors. Of those in private households, many are employed as domestic workers. The third largest category is that of the construction industry (14%), followed by the manufacturing industry (8%).

Figure 3.7 Distribution of informal employment by industry, 2013



Source: Authors' calculations, QLFS 2013.2

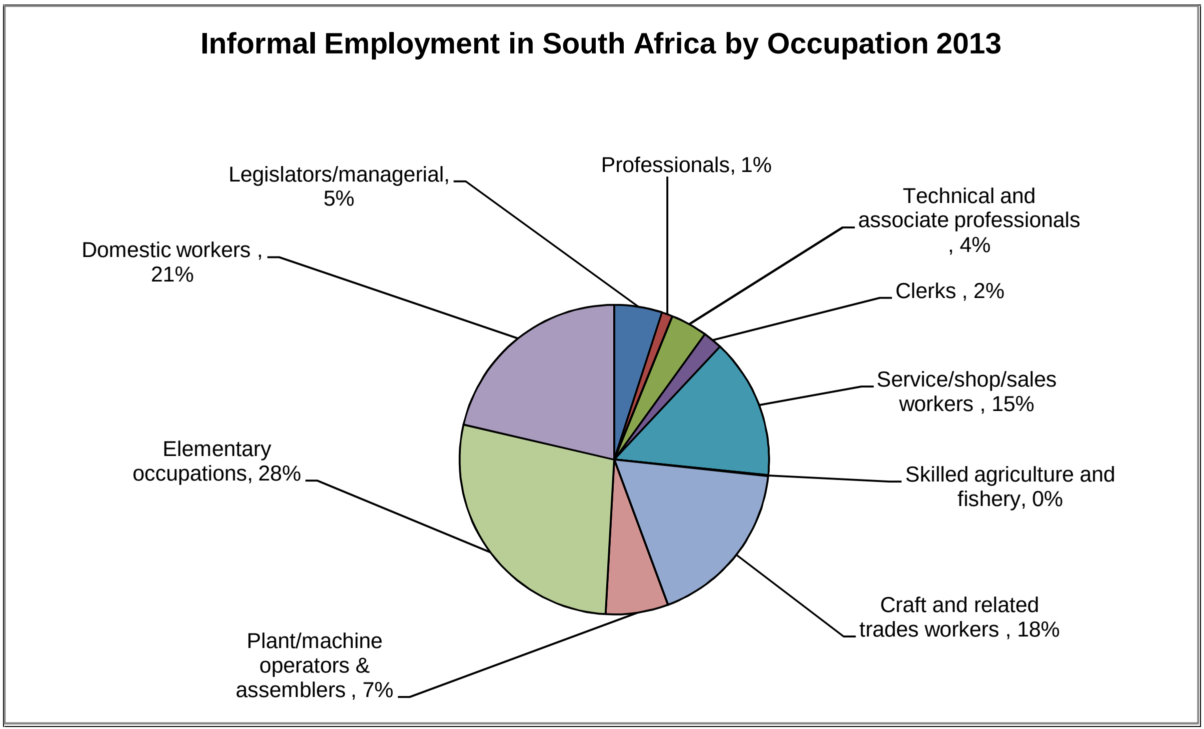
The industry distribution varies when disaggregated according to self-employment and wage-employment. Wholesale and retail trade alone makes up 48.29% of informal self-employment, highlighting the dominance of trade activity in the informal economy in South Africa. The next largest category is that of the construction industry, trailing far behind at a much smaller share of 14%. In contrast to this, waged employment is dominated by employment in private households. Such employment makes up 42% of all informal waged employment. The wholesale and retail trade industry does, however, still feature in waged employment, making up 16.6% of informal waged employment. The third largest category is that of the construction industry, which makes up 14.7% of total informal waged employment.

3.6.9 Occupation

Figure 3.8 shows the occupational breakdown of the informal economy. The largest occupational categories include elementary occupations (28%)[14], domestic workers (21%), craft and related trade workers (18%) and service/shop/sales workers (15%). Together these occupations make up 82% of all informal employment. The two largest occupations on their own (elementary occupations and domestic workers) make up almost half of all informal employment (49%) and are predominantly made up of informal wage employees.

[14] such as sales and services elementary occupations - e.g street vendors, messengers, garbage collectors; agricultural and related; mining, construction, manufacturing and transport labourers

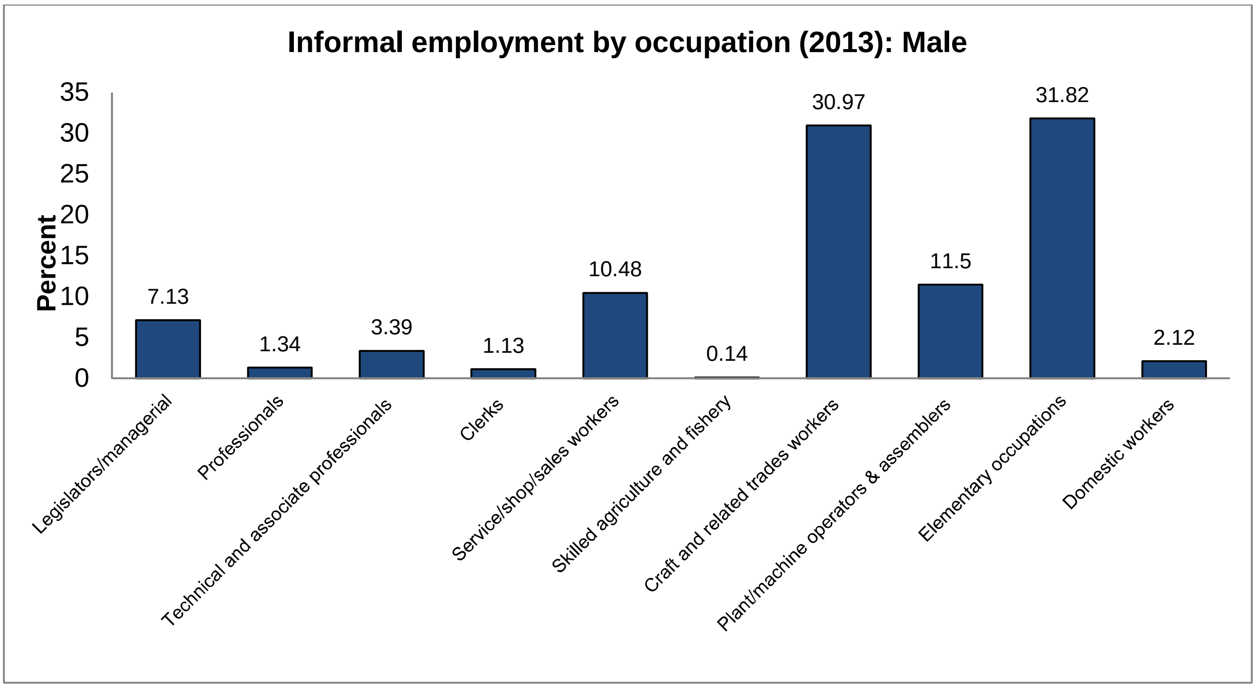
Figure 3.8 Informal employment by occuption, 2013



Source: Authors' calculations, QLFS 2013.2

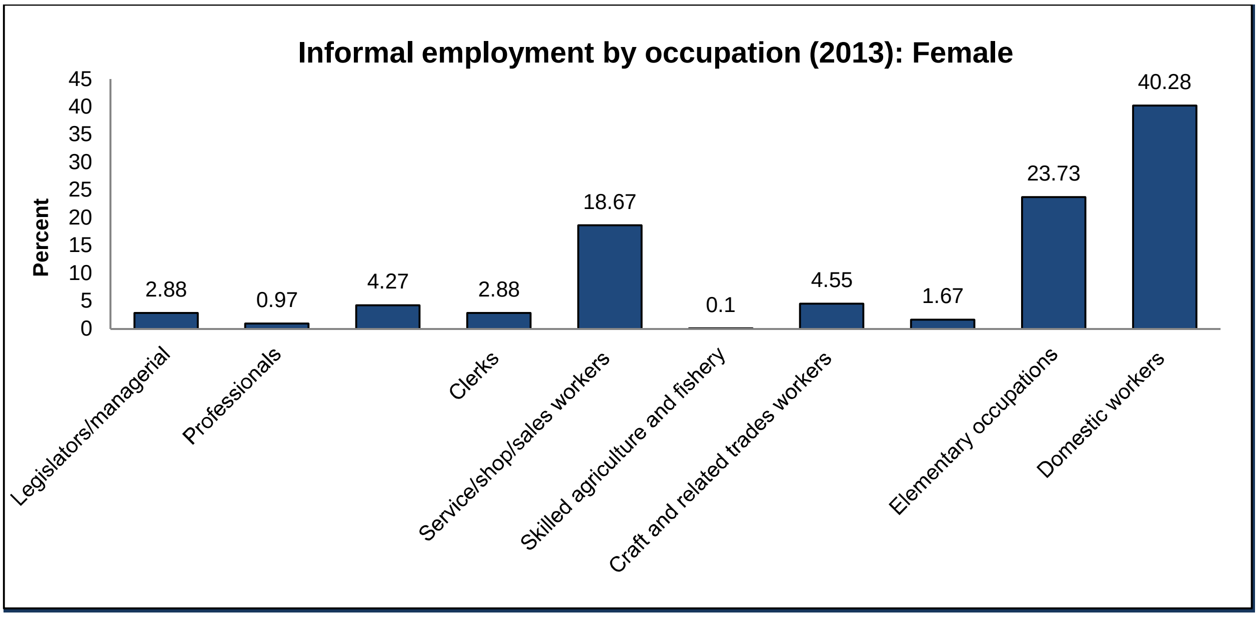
These occupational groupings vary significantly by gender. A large percentage of men in the informal economy work in elementary occupations (31.8%) or are craft and related trades workers (30.9%). Of the women in the informal economy, many work as domestic workers (40.2%) or in elementary occupations (23.7%).

Figure 3.9 Male informal employment by occupation, 2013



Source: Authors' calculations, QLFS 2013.2

Figure 3.10 Female informal employment by occupation, 2013



Source: Authors' calculations, QLFS 2013.2

3.6.10 Earnings in the informal economy

'Informal, unprotected, and non-standard forms of employment are characterized by lower earnings, more precariousness, and higher poverty rates. Households that depend on these forms of employment for their income are significantly more likely to have a standard of living inadequate to meet their basic needs' (Heintz, 2008).

Establishing accurate earnings information from the LFS is problematic as a significant number of respondents either do not disclose earnings information or report zero earnings. The earnings question and variable was also excluded initially when the QLFS was introduced, and earnings information for later years has as far as we could determine not been reintroduced.

Despite the difficulties of estimating earnings from LFS data, Devey et al (2006), Heintz and Posel (2008) and Wills (2009) have all attempted to estimate earnings in the informal economy using data from the LFS. Table 3.10 below summarises the information used for the earnings estimates, with the relevant year's rand amount of the SOAP outlined in the final column.

Table 3.10 Research estimating informal economy earnings

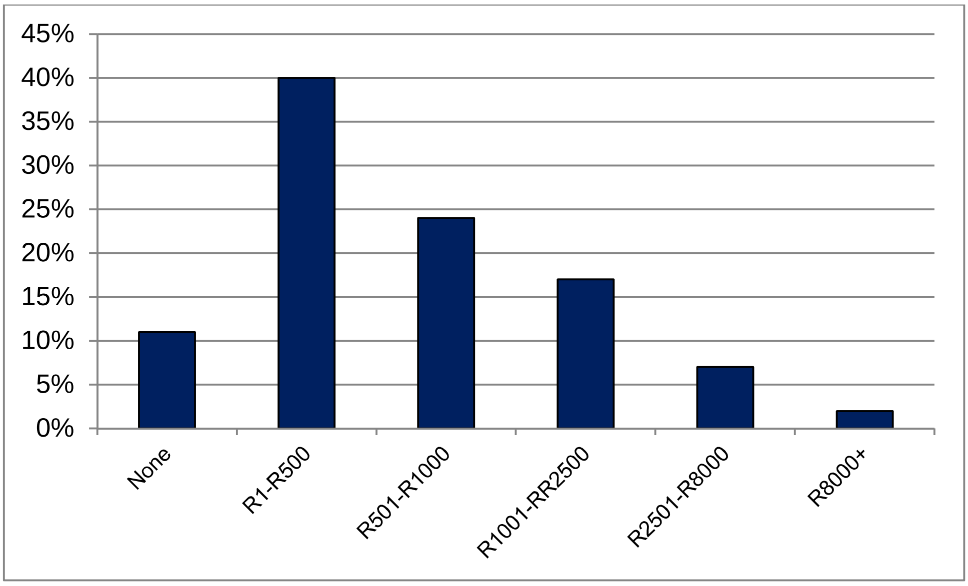
Paper	Informal definition	Data used	Price index	SOAP value
Devey, et al (2006)	Enterprise-based (registration question)	LFS 2004:1	2004 prices	R740
Heitnz and Posel (2008)	Employment-based	LFS 2004:2	2004 prices	R740
Wills (2009)	Employment-based	LFS 2005, 2006, 2007	2000 prices	R740

Sources: Multiple sources, as stated above

The cash value of the SOAP for the respective years outlined in the studies serves as a useful 'cut-off' point in our earnings analysis, as those earning less than this (or the same) per month will not experience a drop in income once they reach retirement age. This is because the SOAP would fully replace – indeed in many cases surpass – their previous monthly earnings. From the perspective of maintaining a reasonable level of earnings compared to pre-retirement earnings into retirement, there would be no reason to include these workers in a contributory system with respect to an old age pension as they are already covered adequately by the SOAP. Those earning more than the SOAP, however, will experience a drop in monthly income upon retirement, making them more likely candidates to include in a contributory pension system. Whether those earning less than the SOAP could benefit from inclusion into risk benefits such as a death or survivors' benefit and funeral benefits remains an open question.

Devey et al (2006) use an enterprise-based definition of informal employment (using the indirect registration questions as a basis for categorising informal and formal enterprises). Using 2004 prices, they analyse the data on the reported monthly earnings (including those reporting zero earnings) of those working in informal enterprises from the 2004 LFS and look at the percentages of those falling into certain income bands. Their results are replicated in Figure 3.11.

Figure 3.11 Distribution of informal workers' mothly earnings



Source: Devey et al , based on LFS 2004

According to their analysis, over half of those in informal employment were earning R500 or less per month. In 2004, the relative cut-off point would be the amount of R740 paid per month by the SOAP. This cut-off point falls mid-way between the lower and upper bound of the third income band outlined in their figure, making it difficult to outline an exact percentage of those in informal work with incomes below and above R740 a month. However, over 50% are *definitely below* the monthly SOAP amount (earning less than R500 a month) and 26% are *definitely above* the SOAP amount (at over R1,000 per month). Almost a quarter (24%) of those in the informal economy earn between R501 per month and R1,000 per month, the income band in which the SOAP falls. While it is not possible to isolate an exact figure of those below and above the cut-off point we can estimate these proportions. Since 50% are definitely below the cut-off point and as the cut-off point falls in the middle of the R501–R1,000 income band, it is certain that a *majority* of those in informal employment (somewhere between 51% and 75%) are earning less than the SOAP when defined according to the enterprise-based approach. Very few in the informal economy earn high incomes, with only 9% earning above R2,500 per month and even fewer (2%) earning over R8,000 per month.

Heintz and Posel (2008) also used data from the 2004 LFS (in 2004 prices), but they use an employment-based approach[15] when defining informal employment. Their representation of the informal economy therefore includes both those employed in informal enterprises (those captured by the Devey et al,analysis) and those employed informally in formal enterprises. Using un-weighted data from the LFS and excluding observations that report no or missing earnings or hours worked,[16] they estimate average *hourly earnings* by formal and informal employment within specific employment status categories. By combining this information with the reported average hours worked weekly per category and multiplying by 4.3,[17] we obtain an estimate of monthly earnings for each reported category. This information is presented below in Table 3.11.

15 Individuals are classified as in formal employment if *either* 1. they are self-employed in a formal (i.e. registered) enterprise or if 2. they are a wage employee with a written contract, or paid leave *and* a pension. If an individual's work characteristics do not meet these criteria, they are considered to be in informal employment.

16 They also exclude those who report more than 140 hours worked per week.

17 52 weeks per year divided by 12 months (52/12= 4.3).

Table 3.11 Estimated monthly earnings by employment category

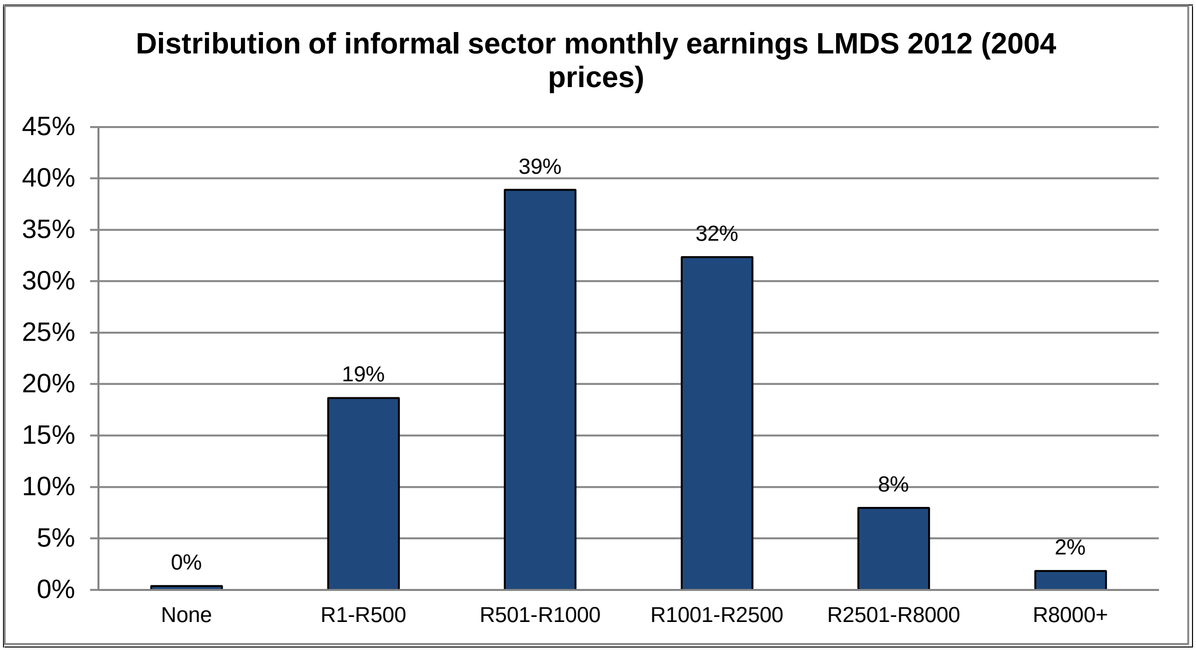
Employment category	Distribution of employment		Average hourly earnings	Std. deviation of average hourly earnings	Hours worked	Average monthly earnings
	No.	%				
Formal						
Non-agricultural, private employee	8,778	34.49	16.49	21.7	45.91	3,255
Non-agricultural, self-employed	830	3.26	41.13	51.8	51.85	9,170
Agricultural employee	1,586	6.23	6.3	9.38	49.04	1,328
Agricultural self-employed	240	0.94	61.8	132.22	51.2	13,606
Public employees	4,211	16.54	29.25	25.11	42.2	5,308
Informal						
Non-agricultural private employee	4,435	17.42	5.43	6.75	43.64	1,019
Non-agricultural self-employed, not own-account	720	2.83	11.69	20.57	46.74	2,349
Non-agricultural self-employed, own-account	1,984	7.79	7.14	16.35	42.79	1,314
Agricultural employee	1,112	4.37	3.62	5.61	19.16	298
Agricultural self-employed	958	3.76	1.41	6.77	28.85	175
Public employee	254	1	8.09	2.66	40.69	1,415

Source: Heintz and Posel (2008), based on LFS 2004

As the comparison year is also 2004, we compare the average monthly earnings of those in informal employment to that of the SOAP of R740 per month. Apart from those in informal agricultural employment, the average monthly earnings across all employment categories are above R740 per month. This seems to imply that those in informal employment are not adequately covered by existing national pensions systems as, on average, they tend to earn above the SOAP amount. This conclusion comes with a couple of caveats, however: 1) relying exclusively on *average* earnings as an indicator disguises the heterogeneity that exists across individual earnings in informal employment (i.e. it does not give us an indication of how many in reality are above and below the average); and 2) the earnings presented by Heintz and Posel (2008) are likely to be biased upwards, as zero earnings have been excluded from their analysis. In reality, significant earnings differentials exist both within informal employment (as can be seen by the earnings differentials across waged employment and self-employment) and within specific informal employment categories (e.g. the standard deviation for hourly earnings for informal self-employed employers is very high, indicating a high degree of dispersion in earnings from the mean).

The latest earnings data from the Labour Market Dynamics Survey (LMDS) suggests that there has been a small increase in real earnings between 2004 and 2012 among informal workers. While the median wage in 2004 was between R1 and R500, the latest LMDS data suggests that this has shifted to R501-R1,000. The proportion of informal workers earning between R1001- R2500 per month has also increased over the eight-year period.

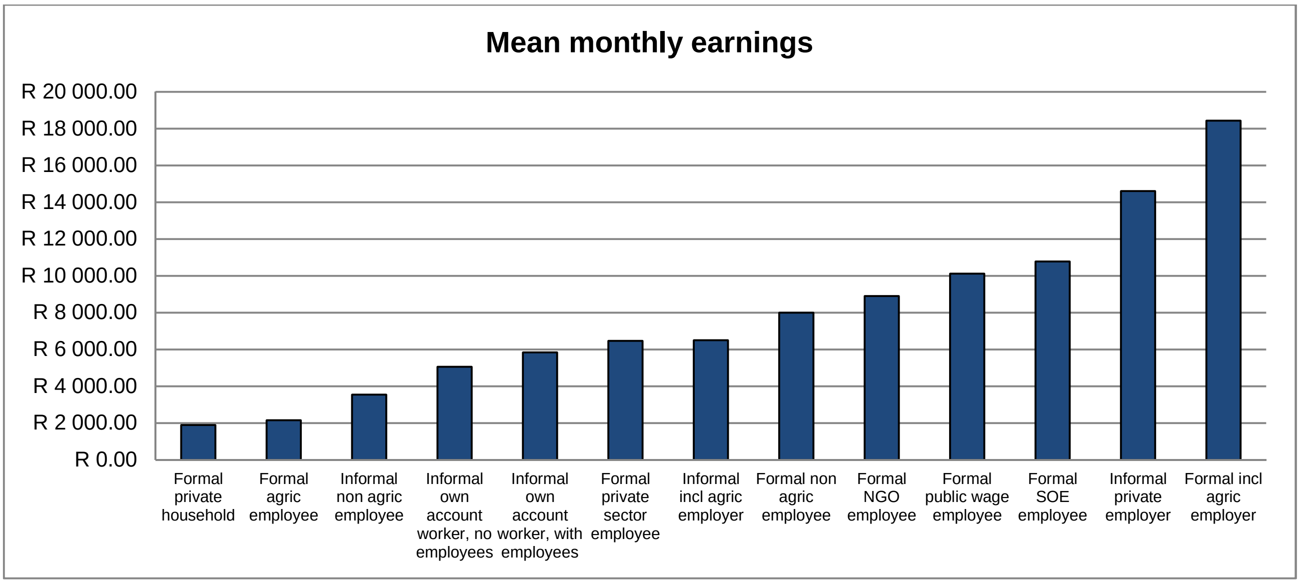
Figure 3.12 Distribution of informal workers' mothly earnings



Source LMDS 2012 (in 2004 prices)

While the Heintz and Posel data does not allow us to compare the percentages of those in informal employment above and below the SOAP in the way that the Devey et al,data did, the information *does* allow us to compare average earnings across different types of employment categories. Figure 3.13 shows a hierarchy of average earnings according to employment category.

Figure 3.13 Average monthly incomes by employment category



Source: Authors' calculations, LMDS 2012

All formal employment categories (apart from formal agricultural wage employees) earn higher average incomes than all of the informal employment categories. In addition, when we compare formal and informal earnings across the same categories (e.g. comparing formal and informal non-agricultural wage employees), the average earnings in the relevant formal employment category are consistently higher than those of the comparable informal employment category, and in most cases by a substantial factor. Of those in informal employment, the self-employed (both own-account workers and employers) earn more on average than those who are informal wage employees. Of those who are informally self-employed, those who are employers (i.e. employ at least one other person) earn more on average than own-account workers (i.e. those who only employ themselves). Those in informal agricultural employment earn significantly less than all other employment categories, even within informal employment.[18]

Wills (2009) uses data from the LFS 2005, LFS 2006 and LFS 2007 to estimate the real average hourly earnings of non-agricultural informal workers in 2000 prices. She uses an employment-based definition of the informal economy and uses the same criteria as Heintz and Posel when classifying workers as formal or informal. The earnings estimates are calculated using weighted data on earnings and hours worked associated with an individual's main job only and excludes individuals reporting zero earnings and those with missing earnings information. Earnings are before tax and any deductions and include overtime pay and bonuses but exclude in-kind earnings. As she uses 2000 prices, we compare the earnings presented to the monthly amount of R540 paid out for the SOAP in 2000. Table 3.12 below shows the distribution of average monthly earnings of those in informal employment according to various income bands.

Table 3.12 Distribution of monthly earnings in informal employment (LFS 2007:2)

Monthly earnings	Wage employees		Self-employed		Totals	
	%	Cumulative %	%	Cumulative %	%	Cumulative %
R1–R200	0.50%	0.50%	2.09%	2.09%	0.56%	0.56%
R201–R500	2.88%	3.37%	5.70%	7.78%	3.00%	3.56%
R501–R1,000	8.80%	12.18%	12.22%	20.00%	8.95%	12.52%
R1,001–R1,500	9.58%	21.76%	7.66%	27.67%	9.50%	22.01%
R1,501–R2,500	17.67%	39.43%	17.31%	44.98%	17.65%	39.67%
R2,501–R3,500	12.76%	52.19%	9.81%	54.78%	12.64%	52.30%
R3,501–R4,500	7.30%	59.50%	5.32%	60.10%	7.22%	59.52%
R4,501–R6,000	8.25%	67.75%	6.91%	67.02%	8.20%	67.72%
R6,001–R8,000	7.10%	74.85%	5.98%	73.00%	7.05%	74.77%
R8,001–R11,000	7.91%	82.76%	7.39%	80.39%	7.89%	82.66%
R11001-R16000	8.70%	91.46%	5.79%	86.18%	8.58%	91.24%
R16001-R30000	6.47%	97.93%	7.98%	94.17%	6.53%	97.77%
R30000+	2.07%	100.00%	5.83%	100.00%	2.23%	100.00%

Source: Authors' calculations, LMDS 2012

The SOAP amount of R540 per month is contained within the third income band of the table. 30% of those in informal employment definitely earn less than the SOAP at 2000 prices (at R500 or less per month). The income band that includes the SOAP amount (i.e. R501–R1,000) also includes the largest number of those working in informal employment, i.e. 38% of those in informal employment earn between R501 and R1,000 per month in 2000 prices. As the SOAP amount is contained within this band, it is difficult to estimate the exact number of people below and above the line. However, as the SOAP sits toward the bottom end of the income band, it is feasible that a higher proportion are above the line (i.e. the total percentage of those below the line may not be much higher than the 30% mentioned above).

Comparing this information to that of Devey, Skinner and Valodia, it seems as if a higher proportion of the informal economy is situated below the SOAP cut-off when the enterprise-based definition of informality is used. This is true even after adjusting the Devey et al, numbers in order to remove those with zero earnings

18 For example, those who are informally self-employed in the agricultural sector earn R175 per month on average, 7.5 times less than those in non-agricultural employment in the next lowest income category (i.e. informally self-employed own-account workers at R1,314).

from their data. This seems to suggest that those working informally in formal enterprises (who would be excluded in the Devey et al, method but included in the Wills methodology) earn more on average than those working in informal enterprises. When using an employment-based definition of informal employment, we are therefore likely to see more informal workers with earnings above the SOAP cut-off (i.e. higher numbers of those likely to experience a drop in monthly income upon retirement) than we would using an enterprise-based definition.

Table 3.12 shows the variation that exists in earnings within informal self-employment and within informal waged employment. 30% of informal wage employees earn no more than R500 per month whereas the percentage for those is informal self-employment is 39%, i.e. a higher proportion of those in self-employment earn very low incomes. Looking at an even lower income ceiling, 13% of the informally self-employed earn less than R200 per month whereas only 5% of informal wage employees do. However, looking at average earnings across the two categories, those in informal self-employment tend to have higher earnings than those in informal waged employment. This is because a higher proportion of those in informal self-employment earn relatively high incomes – 11% of those who are self-employed earn over R2,500 a month (pulling averages up) whereas only 4% of wage employees do. While we can conclude that those in informal self-employment *on average* earn more than those in informal waged employment, it is important at the same time to acknowledge that informal self-employment has an earnings distribution that is much more dispersed than that of informal waged employment.

Wills (2009) also looks at the trends in hourly earnings across different employment categories from 2005 to 2007. These figures are replicated below in Table 3.13. In the formal economy, average hourly earnings have increased slightly over this time period. Average hourly earnings for informal wage employees have remained relatively constant, but those for the informally self-employed have increased (from R5.91 to R8.89 per hour). She attributes this increase to a shift in the occupational distribution of informal self-employment, away from lower earning elementary occupations and toward higher paying craft and related trade occupations.

Table 3.13 Real average hourly earnings, 2005–2007

Real average hourly earnings	2005			2006			2007		
	Men	Women	Total	Men	Women	Total	Men	Women	Total
Formal									
Formal employment	20.912	19.06	20.191	24.025	19.752	22.342	23.03	20.66	22.078
Wage employee	19.474	18.51	19.09	20.921	18.838	20.086	21.05	20.02	20.625
Self-employed	40.674	31.81	38.216	64.355	34.439	57.196	50.853	32.705	44.769
Informal									
Informal employment	6.663	4.834	5.745	6.988	5.276	6.15	7.765	6.163	9.955
Wage employee	6.185	5	5.634	6.048	4.915	5.509	6.304	5.245	5.783
Self-employed	7.53	4.628	5.91	8.584	5.807	7.166	10.372	7.576	8.894

Source: Wills (2009)

The table also allows us to outline earnings gaps between the formal and informal economy as well as differences in earnings for men and women. Based on average hourly earnings across formal and informal employment, those in informal employment earn considerably less than those in formal employment. Those in formal employment earn as much as three or four times the amount that those in informal employment earn (Wills, 2009). Within informal employment, the informally self-employed have higher average hourly earnings than those in informal waged employment (as mentioned previously), a finding that is consistent with the Heintz and Posel data. Women consistently have lower average hourly earnings than men both in formal and informal employment and across each respective employment category.

Wills (2009) also provides information on average earnings across occupational groups in the informal economy. This information is replicated in Table 3.14. While on average those in informal self-employment tend to earn more than those in informal waged employment, within occupational groups there appears to be more variation. Professionals, technical and associate professionals and clerks all earn more on average in informal waged employment than those in the same occupational categories in informal self-employment. Meanwhile, the earnings differentials across waged and self-employment in legislative/managerial jobs and elementary occupations is marginal, and for all other occupational groups those in informal self-employment earn more than those in informal waged employment.

Table 3.14 Average earnings across occupational groups

Occupations	Informal wage employees		Informal self-employed	
	Av. monthly earnings	Std. dev.	Av. monthly earnings	Std. dev.
Legislators, senior officials and managers	R18,569.60	R28,014.16	R17,157.15	R20,634.43
Professionals	R19,561.03	R32,728.22	R22,784.44	R20,459.84
Technical and associate professionals	R9,963.75	R17,812.63	R10,465.19	R11,934.22
Clerks	R7,088.53	R13,204.65	R5,001.61	R7,226.02
Service workers and shop and market workers	R4,936.73	R9,875.90	R4,631.03	R7,405.67
Skilled agricultural and fishery workers	R3,262.60	R4,396.47	R2,907.37	R2,126.60
Craft and related trades workers	R5,805.31	R10,885.19	R5,129.48	R12,165.09
Plant and machine operators and assets	R4,588.12	R8,306.76	R6,778.27	R10,491.77
Elementary Occupations	R3,188.24	R12,278.66	R2,797.50	R4,713.56
Domestic workers	R1,599.95	R8,964.86	R2,157.00	R1,007.92

Source: LMDS 2012

The three occupational groups that make up the largest proportion of those in informal employment are highlighted in the table (see Figure 3.7). When combined, those working in elementary occupations (29%), as domestic workers (20%) and in craft and related trades (18%) make up two-thirds of those in informal employment. Of these groups, domestic workers have the lowest average earnings at R566 per month. Elementary occupations have slightly higher average earnings at R784 if self-employed and R818 if a wage employee. Craft and related trades workers earn slightly more at R1,271 if self-employed and R1,057 if a wage employee. Street vendors (as a category within elementary occupations) make up a large proportion of those in informal employment (around 15%). On average, street vendors earn between R705 (if selling foodstuffs) and R963 (if selling non-foodstuffs) per month. Average monthly earnings in informal employment are highest for professionals (R4,500 and R5,065) and those in legislative/managerial positions (R3,362 and R3,264). However, these two occupational groups make up only 6% of those in informal employment, suggesting that high earnings potential is limited to a small number of those in informal employment.

Overall, the three papers' findings on earnings in the informal economy suggest the following:

- Those in **formal employment earn (significantly) more** than those in informal employment;
- Across both informal and formal employment (and within employment categories), **men on average earn more than women**;
- Within informal employment, on average the **self-employed earn more than wage employees**, with the caveats that:

  Earnings are more dispersed in self-employment than in waged employment. While the self-employed are more likely than wage employees to earn relatively high incomes, there are also larger proportions of those in self-employment than those in waged employment earning very low incomes;

  In some occupational groups (professionals, technical and associate professionals, and clerks) the opposite is the case, with **wage employees earning more** on average **than the self-employed**. However, these occupational groups only make up a small proportion of informal employment;
- Within informal self-employment, on average employers earn more than own-account workers;
- Within informal employment, the **occupational groups that make up the majority of informal workers are those characterised by relatively low average earnings**, while the occupational groups that make up the minority of those in informal employment tend to have higher average incomes;
- While the income-generating potential of those in the informal economy varies both across and within waged employment and self-employment, **very high earnings potential is nevertheless limited to only a small minority** of those in the informal economy; and
- Recent estimates do not allow for very precise conclusions about the number of informal workers earning less than the SOAP, and earnings data from the QLFS for the last three years are not available. Based on the most recent work from Wills (2009), 33.6% of informal workers definitely earned less than the SOAP (less than R501 per month in 2000 terms). About 33% of informal workers definitely earned more than the SOAP, with another third falling in the income interval around the 2000 value of the SOAP.

3.6.11 Other relevant aspects

3.6.11.1 Labour market churning

Research suggests that there is a high degree of movement between formal and informal employment in South Africa (Valodia, 2006:5). Devey et al, (2006:17) estimated the levels of labour market churning based on the LFS from 2002 to 2004 and found a surprisingly high level of churning, with the status of more than half of the workers changing over a two-year period. Those who did not change tended to be either permanently in formal employment or permanently economically inactive. There was a high level of movement between informal unemployment and being economically inactive (37.3%), as well as high levels of movement between formal and informal employment (18.3%).

Table 3.15 Shifts between informal work and other labour market status

Type of change	Frequency	%
Informal and unemployed and not economically active	191	18.9
Informal and not economically active	190	18.8
Informal and formal	185	18.3
Informal, formal and unemployed	77	7.6
Informal, formal and not economically active	73	7.2
Remained in informal	71	7.0
Informal and unemployed	60	5.9
Informal, formal, unemployed and not economically active	44	4.4
Other	118	11.7
	1,009	**100.0**

Source: Devey et al, (2006)

Case studies have also found that many of those in informal employment *also* had a job in the formal sector. For example, AICDD (2005) found that in the sample of informal workers surveyed in Mangaung, 20% had additional jobs in the formal sector. However, as this information is not currently captured in the LFS, it is difficult to estimate how common this is outside of the areas in which these studies have been conducted.

3.6.11.2 The informal economy's contributions to GDP

Reconciling data from household surveys with national accounts is a notoriously difficult task in any country, making it difficult to give an accurate estimate of the size of the contribution the informal economy makes to GDP. Nevertheless, estimates have been made as to how much the informal economy contributes to GDP in South Africa. Based on household expenditure surveys, the South African Reserve Bank estimates that the informal economy contributes around 7% to South Africa's GDP (Devey, Skinner and Valodia, 2006). However, Budlender et al. (2001) estimated that the contribution is closer to 12%. These estimates are both based on enterprise-based definitions of the informal economy and hence the actual contribution is likely to be greater than these estimates, particularly in a context of increasing use of informalised forms of labour in many industries in the country.

3.6.11.3 Social protection

In 2007, only 2% of informal employees received medical aid contributions from their employer (compared to 40% in formal employment) and less than a quarter reported that unemployment insurance contributions were made on their behalf (Wills, 2009:41). Devey et al,(2004:28) found that only 11.8% of informal employees report that their employer contributes toward a pension or retirement fund and only 16.4% are given paid leave. The self-employed are particularly vulnerable to loss of income if they fall ill (Lund and Ardington, 2006) and have little access to insurance mechanisms to protect themselves against this likelihood.

3.7 Conclusions

There are notable recent international trends that have come to characterise informal work. These need to be considered when attempting to understand the informality of employment or when developing any intervention programmes that may be of assistance to informal workers. Globally speaking, people partake in informal work for a variety of reasons, and in a wide range of sectors. Some of these sectors are actually formal, but the nature of the working conditions in them is largely informal. Informal work also has a huge variability in earnings potential. In some cases, it is very high but in most it is very low.

In South Africa, the proportion of the labour force in informal employment remains smaller than perhaps that seen in other southern African countries and sub-Saharan African countries. However, there are many indications that this sector is growing. Currently, there are no indications that this growth trend will change. If anything, it is becoming increasingly difficult to create formal employment opportunities in South Africa.

One of the underlying characteristics of informal work in South Africa is that incomes are largely low and intermittent. That said, the majority of informal workers earn more than the SOAP, for which they would be eligible upon retirement. Because of this, their earnings replacement once retired, in the absence of any other retirement provision scheme, is very low. This is, in most cases, accompanied with the associated decline in standard of living.

Informal worker earnings in South Africa are on the rise, in real terms. While the median informal worker earned less than R500 in 2004, the latest household data suggest that this median band has increased to between R500 and R1,000. Informal worker earnings also vary greatly by type of informal worker, by employment category, and by gender. Household data suggests that those informal workers that are self-employed, and sometimes employ other workers, earn more than those that work for someone for a wage. Generally, those in private households and agricultural sectors earn the least, while those in NGOs and some state-owned enterprises earn more. Male informal workers earn more than women, on average – mirroring the earnings trends also characteristic in the formal sector.

The main implication of all this is that there is a large, diverse proportion of people in informal work in South Africa that has limited social protection. Tailoring the right kind of social protection scheme requires that all these considerations are carefully deliberated. The following chapter looks at specific cases from around the world and also from South Africa, from which more can be understood about the nature of informal work and the kinds of schemes that have been successful in providing social protection to these workers.

4 International and South African experience with social protection for informal workers

This chapter presents a number of case studies of social insurance reform from a number of countries that have managed to institute social reform successfully. It also highlights some of the challenges and successes that the extension of social protection to those with vulnerable employment in South Africa has faced and achieved. While the background and contexts of each of the countries are different, there are salient features of the interventions from which insights can be drawn.

4.1 Chile

Chile was the first Latin American country to undertake a major structural reform to its social security system in 1981. The public defined-benefit PAYG model was replaced by a single fully funded DC system with individually capitalised accounts (ECLAC, 2006). This social insurance system was created as an additional tier within a means-tested social assistance pension available to those over 65. Participation was made mandatory for all formal employees and voluntary for the informally and self-employed. While a minimum pension was guaranteed for workers fulfilling the contribution requirements of 20 years of contributions (adding a redistributive element to the system), benefits were linked more directly to the level of contributions made (increasing the incentive to contribute). Individual accounts became portable between occupations and sectors (making it more flexible) and management of the system was privatised, allowing specialised private sector managers to compete for affiliates (making the returns more attractive), with the state playing an overall regulatory role and providing guarantees of minimum returns. Employees are required to pay 13% of their monthly income into the system, although flexibility in contributions is afforded to temporary and/or seasonal workers who can only make irregular contributions (Hu and Stewart, 2009). In addition to the minimum guaranteed pension, minimum disability and survivorship pensions are also offered to workers who meet certain conditions.

Notwithstanding the continued problems most countries face in including informal workers in social insurance systems, Chile has achieved a relatively high level of coverage of informal workers. In 2003, Chile had the second highest percentage (64.9%) of the employed population making contributions into their social security system in the Latin American region. These rates of coverage were high even in rural areas (reaching 48.8% of those employed in rural areas) and for urban informal wage employees (at 50.8%). Several aspects of the system make it attractive to those in informal employment. The minimum pension guarantee (with government top-ups/subsidisation for those who have not been able to make the full level of contributions) ensures that those contributing will not lose their contributions. Low-income workers have an incentive to contribute to the system even if they can only make small contributions, as they are guaranteed benefits in retirement. The inclusion of disability and survivorship benefits as a part of the social security benefits is also likely to be attractive to those in informal employment. The private administration of the system (with higher returns) is likely to make the system attractive for all workers, but is a particularly important aspect when attempting to increase voluntary participation. Flexible contributions for those with irregular incomes are also an attractive element of the system for informal workers with irregular incomes.

Although the system has made some progress in terms of inclusion of informal workers, just as with many other countries more remains to be done and further reforms to the Chilean system are being put in place in an attempt to increase inclusion.

4.2 Tunisia

A difficulty that governments face when including the self-employed or informal workers into contributory systems relates to the setting of contribution rates for these workers. Formal wage workers (along with their employers) are generally required to contribute a set percentage of their earnings into the social insurance system. This is easy to enforce as earnings information is easily verifiable in a formal wage relationship, making contributions easily enforceable. However, for both the self-employed and the informally employed, accurate verification of earnings becomes difficult as earnings have to be self-reported. Both informally and self-employed workers have incentives to underreport earnings in order to minimise their contributions. Informal workers are also reluctant to disclose their true earnings for fear of the possible tax implications of this disclosure. Applying the same contribution rules (i.e. a set percentage of earnings) to the informally and self-employed is therefore likely to lead to a lower level of contributions than is optimal. This is problematic both in terms of the fiscal sustainability of the system itself and for those paying into the system, as they will be entitled to lower benefits. An alternative to this would be to put in place a flat-rate contribution rule, but this is also likely to create problems. The rate would have to be set relatively low in order to ensure the system is affordable for low-income workers. At the same time, however, setting the rate too low would also lead to low contribution problems.

Tunisia successfully addressed this by adopting an innovative method for determining contribution rates in its social insurance system. The system used is affordable for low-income workers but avoids the problems of low contributions from those who can afford to pay more into the system. This was done through the creation of an accurate income estimation system for the self-employed. Through regular consultations with representatives of the sectors that coverage was being extended to, the government was able to gain a better understanding of the needs and income levels of each of these sectors. The government was then able to create realistic income scales to determine the lowest income bracket for individuals according to a combination of two things: (1) the occupational group to which the individual belongs (e.g. physician, shopkeeper, etc.); and (2) the size of the firm in which an individual works. Individuals are classified according to these two criteria and then required to pay a minimum contribution to the system according to the income bracket applicable to them (Olivier, 2009).

The system ensures that contributions are more closely aligned to earnings, thus ensuring that those who earn more pay more into the system. However, while the income bracket determines an individual's minimum required contribution, some flexibility has been introduced to the system to allow individuals to pay more or less into the system according to their needs. Any individual can pay more into the system if they choose to do so in order to receive higher benefits at a later date. The system also allows individuals to pay less than the minimum if they provide proof that their real income is below the income bracket that applies to them. Consequently, the system is therefore more closely aligned with the individual's ability to pay into the system. It ensures that those with higher earnings contribute more than the bare minimum, that the system is affordable to those with low earnings, and that those with a willingness to pay more into the system have the option to do so. A key part of the success of this system was the consultative process used by the government to create the income estimation system, as well as the corresponding education programmes that were put in place to educate workers on the new system. Since the introduction of the income estimation system, Tunisia has seen coverage expand from around 60% in 1989 to 84% in 1999 (Chaabane, 2002 in Van Ginneken, 2009).

4.3 Brazil

The *Previdencia Social Rural* scheme has been successful in extending pension and disability coverage to the rural poor in Brazil. The rural social security system has been in existence since 1971 but was enhanced in 1988 with the new Federal Constitution (ILO, 2010). The system itself is non-contributory but targets particular geographical areas by limiting benefits to those in informal rural employment. This includes rural labourers, as well as those family farmers in subsistence agriculture, fishing or mining. In order to be entitled to benefits, an individual has to fulfil a requirement of a minimum of 12 years of activity in the agriculture sector. If an individual qualifies, the programme provides a monthly benefit equivalent to a minimum wage to men who are over 60 and women who are over 55 or to their dependents in the event of death or disability. Agricultural workers have the option to voluntarily contribute to the same national social insurance system that formal urban workers contribute to in order to enhance their benefits. The system itself is partly financed from general tax revenue and partly from taxes levied on the sale of agricultural goods (sometimes dubbed a 'semi-contributory' approach). In 2009, the subsidy paid from Brazilian National Treasury for rural benefits was equivalent to 1.3% of GDP. As contributions are not made by individuals themselves and the primary aim is a reduction of poverty, the system itself is that of a social assistance programme, albeit one targeted specifically to rural areas and those in informal employment.

The system has achieved a high degree of coverage. In May 2010, the Brazilian government was paying social security benefits to 27.3 million people, of which around a third were *Previdencia Social Rural* benefits (ILO, 2010). It is estimated that the system provides poverty relief to around 22.6 million people in Brazil, which is roughly 12.3% of the population (ILO, 2010). The system has also had more dynamic effects in that it has been found to create a significant boost for household economic activity and has increased school enrolment for children in rural areas (Barrientos, 2002b). While the programme has been successful for the most part, problems remain and many rural workers are unable to access benefits. It is estimated that around 3 million rural workers are unable to access benefits as their work is seasonal and they have no fixed job or address, making it difficult to prove that they fulfil the minimum 12 years of activity criterion (ECLAC, 2006). Adjustments to the system may be needed to extend coverage to workers operating under these circumstances.

4.4 Kenya

The Mbao Pension Plan in Kenya is a voluntary individual account savings plan to which all workers in Kenya may contribute without regard to income or age. The plan is tailored to offer a voluntary contributory pension scheme that is suitable for the informal sector. The plan is also aimed at promoting savings and a culture of saving for workers in the informal sector in Kenya. An outstanding feature of the Mbao Pension Plan, and one that overcomes one of the central challenges of providing for retirement plans for informal workers, is that participants can conveniently make contributions anytime and anywhere using mobile phones (Kwena and Turner, 2013). This enables workers to contribute to the plan easily, as network coverage in Kenya is high, and contribute at relatively low cost. This savings innovation is made possible by technological innovations that have reduced the costs of mobile phones and airtime, and by the entrepreneurial innovation of mobile money (Kwena and Turner, 2013:1). The plan is provided through private sector businesses.

Mbao was started by the Kenya Jua Kali Co-operative Society to help its members to save regularly toward a long-term and reliable income upon retirement but was extended to all Kenyans because of its success and demand. The scheme was first registered in 2009 and launched in 2011 – by 2014 the scheme had 51,000 members (out of a potential number of informal workers of 8.5 million).

Minimum contributions are low and can be made flexibly, as long as participants contribute at least US$5.00 per month. These contributions can only be made through M-PESA, a very widespread mobile phone-based mechanism for transferring funds. This makes it very easy for people to pay contributions because distance from financial institutions and other payment agents is not an issue, and payments are also less costly because they do not flow through the banking system.

While it is still rather early to assess the value for money of the scheme, it is possible to learn from the level of uptake the scheme has enjoyed among Kenyan informal sector workers. Its success so far has been dependent on very high mobile penetration rates – and perhaps also because of a loophole in the banking regulations that meant that M-PESA as deposit-taker did not need to register as a financial institution. It shows the large expansion in retirement saving that is possible in poor and rural communities given alternative technology. This indicates that a traditional constraint to enrolling informal and self-employed workers can be reduced by modern ICT, particularly mobile telephone technology.

4.5 South Africa

Some informal workers in South Africa have been included in social insurance systems, the most notable of which is the UIF. This part of the study included a review of the South African literature relevant to the inclusion of informal workers in social insurance mechanisms. The focus is on the extension of coverage of unemployment insurance to certain categories of informal workers in South Africa over the last decade.

The experience of the inclusion of domestic and farm workers shows that 'scary predictions about mass job destruction and crippling administrative burdens' (Samson, 2009) were not borne out. In fact, this extension is generally seen as a success, with coverage extended effectively to a very vulnerable part of the South African labour market. The experience provides useful pointers to factors that need to be considered in the extension of social insurance. It seems that administrative barriers are often overestimated. The experience also points to the need for an occupational or sub-sectoral approach – the need to incorporate the particularities of specific occupations into both the framing of legislation and the implementation of strategies – and that a 'one-size-fits-all' approach is unlikely to succeed. In addition, extension of social insurance coverage will rely on complementary and sometimes prior labour reforms, such as the protection of basic labour rights and regulation of conditions of employment.

Given the diversity of informal employment, it is clear that domestic work with the existence of a clearly identifiable employer cannot be seen as typical of informal work. Most informal workers are self-employed and there are cases where work is irregular and fragmented. Hence, the inclusion of domestic workers in the UIF cannot be a model for the extension of social insurance to all other categories of informal work.

While the extension of unemployment insurance therefore points to some mechanisms to incorporate informal workers in broader social insurance and retirement reform, there is room for substantially more in-depth study. There have been few assessments of recent South African experience, and those that exist are small studies. The detailed data and administrative records required to make an in-depth assessment of individual measures and their impact are generally not available. The study team has requested recent data on the contribution and claims experience of beneficiaries, but these are still awaited from the UIF.

Moreover, a scarcity of literature and data made a useful analysis of a range of other potentially relevant interventions and initiatives similarly impossible. Specifically, this study also explored the available literature on low-income medical schemes in South Africa, the available information on the development of low-income savings products by the Association of Savings and Investment Schemes of South Africa, and the South African experience with funeral benefit schemes. In none of these cases could we find significant material from which substantial lessons for the extension of retirement insurance to informal workers could be extracted.

4.5.1 Overview of the UIF

The UIF is a small but key component of the South African social protection system. In South Africa, unemployment insurance dates from 1937 when it was introduced for specific industries, with a more comprehensive compulsory system being established in 1946 (Olivier et al., 2003). The earlier legislation on the UIF dating to 1966 was significantly amended in 2001 and it is currently regulated by the Unemployment Insurance Act, No. 63 of 2001 and the Unemployment Insurance Contributions Act, No. 4 of 2002.

The fund provides short-term income to workers in the event that they become partially or fully unemployed as a result of dismissal, retrenchment or illness, on condition that they have contributed to the fund. The UIF also provides benefits to contributors in the case of maternity and adoption, and provides an income to the dependants of deceased contributors. In addition to cash benefits, the UIF invests in the training of employees who are registered with the UIF and are unemployed, in order to provide them with the skills that will allow them to be reabsorbed into employment.

In order to receive benefits, contributing workers have to be unemployed or ill for more than 14 days. Workers who become partially or fully unemployed can claim benefits 14 days after their last day of work. In order to access maternity benefits, women have to apply at least eight weeks before or within six weeks of the birth of the child (SouthAfrica.info, 2003). Also, 'benefits are only paid in the period immediately following the cessation of work and the person must have been contributing to the UIF at the time the event related to the cessation of work occurred. Benefits may be claimed for up to 238 days' (Leibbrandt et al., 2010).

Table 4.1 UIF benefits and recipients, 2008/09–2012/13

	2008/09	2009/10	2010/11	2011/12	2012/13
Benefits (thousands)					
Unemployment	2,833,539	4,535,973	4,322,279	4,472,968	4,781,257
Illness	211,639	231,784	236,901	236,604	254,286
Maternity/adoption	537,574	624,373	668,472	712,245	765,978
Dependants	263,866	317,263	321,327	316,184	320,691
Total benefits paid	**3,846,618**	**5,709,393**	**5,548,979**	**5,738,001**	**6,122,212**
Beneficiaries (thousands)					
Unemployment	475	629	578	556	581
Illness	26	25	23	21	21
Maternity/adoption	94	104	104	104	104
Dependants	16	22	27	25	25
Total beneficiaries	611	780	732	706	731

Source: South Africa 2013

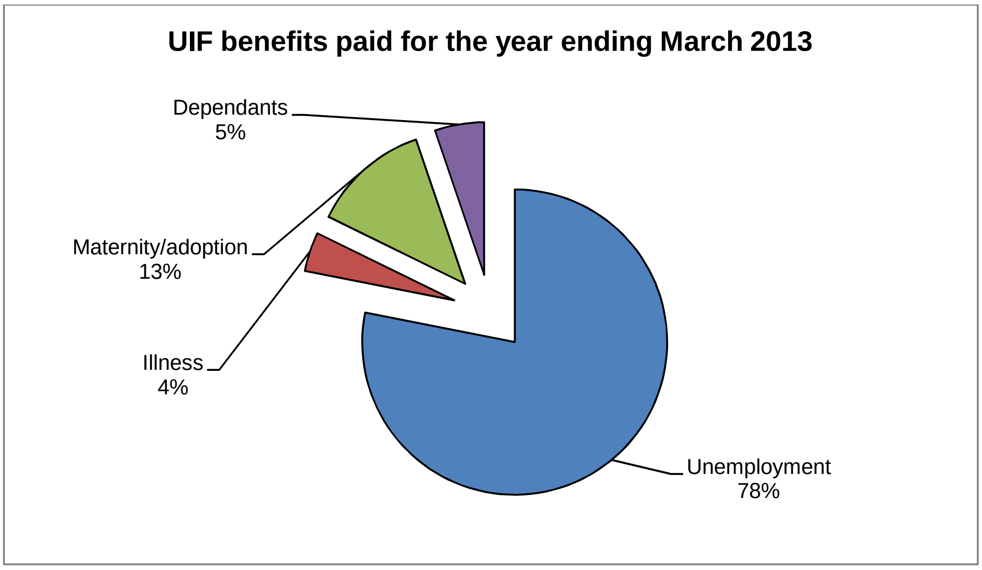
In March 2013, 1,465,218 employers and 8,330,760 employees were registered with the UIF (South Africa, 2013). Registered employees comprised about 45% of the labour force, 60% of the employed (estimated at 13.6 million people in March 2013), and 86% of the formally employed (QLFS March 2013).

The total beneficiaries in 2012/13 numbered 731,131 (Table 4.1) and the total value of benefits amounted to R6.1 billion. Of those receiving benefits, the largest number received unemployment benefits (581,074), with 106,339 receiving maternity benefits and a smaller number receiving illness and adoption benefits (Figure 4.1).

While membership and benefit payments are therefore substantial, the UIF deals with only a small proportion of the income insecurity resulting from unemployment in South Africa. The number of recipients of unemployment benefits of 581,074 for the whole of 2012/13 compares to a total number of unemployed in the economy of 4.6 million in March 2013 (QLFS March 2013).

A large proportion of unemployed workers do not qualify for benefits because they have not contributed (many of the unemployed have never been employed or employed in positions where contributions were made on their behalf) and many of the unemployed could have exhausted their benefits as a result of long-term unemployment. Leibbrandt et al. (2010), on the basis of 2007 Stats SA data, indicate that 55% of the unemployed say they have never worked before and 44% have been unemployed for longer than a year. In the first case, there would have been no contributions and no membership of the UIF. In the second case, the benefits would have been exhausted. In addition, a significant number of workers are informal workers who have not made contributions themselves.

Figure 4.1 UIF benefits paid by benefit type



Source: South Africa 2013.

4.5.2 Registration, contributions and collection

Employers are required to register themselves and declare their qualifying employees with the UIF. The fund holds a database of all employees registered, along with their records of employment. The three main categories of employers registered are commercial employers, domestic employers, and taxi employers.

Contributions are paid by the employer, who is required by law to register with the Unemployment Insurance Commissioner. The employer is required to deduct the UIF contribution from their employees' remuneration and pay both their contribution and employees' contribution to the Unemployment Insurance Commissioner, who pays the contributions to the UIF. Employers and employees must each contribute 1% of 'the remuneration paid or payable'.

UIF contributions are payable monthly, but employers need to deduct UIF contributions at such intervals as employees are paid. The employer is liable for interest on late payments to the fund if contributions are paid later than seven days after month end. Default penalties are imposed if employers default on monthly payments (South Africa, 2002). Much of the onus for registration and contributions to the fund therefore lies with the employer, which functions as the agent for the state.

4.5.3 Administration and funding

The UIF is administered internally through the Siyaya Operational System. The system processes the registration of employees, employers, benefit claims and payments (South Africa, 2010). The costs of administration are deducted from the UIF and a target of costs to payments collected of 1.5% has been set (South Africa, 2002). The administration costs amounted to about R1.2 billion in March 2013 (South Africa, 2013).

Actuarial valuations are regularly conducted in order to determine the future financial requirements of the UIF. The funds are invested with the Public Investment Corporation and some deposits are held with private banks. The most recent valuation (2013) showed that the UIF was in a sound financial position and that it would be able to meet the predicted unemployment insurance claims.

The Fund's investment portfolio increased by 25.16% in the 2012/13 financial year, amounting to R81 billion in comparison to the prior year's R64.85 billion (South Africa 2013). In recent years, expenditure has exceeded revenue, contributing to growing surpluses; the fund's surplus for the financial year amounted to about R16 billion. One factor contributing to the strengthening revenue streams has been the collection of contributions by the South African Revenue Services (SARS), because administration of the Unemployment Insurance Contributions Act (2002) was assigned to the Commissioner for the SARS. As a result, employees who were already registered with the UIF could pay the UIF contributions through the normal tax channels.

4.5.4 The UIF and informal workers

Until 2003, a large proportion of informal workers were excluded from the UIF. While the UIF Act of 1966 (in operation until 2001) used a broad definition of contributor,[19] which could also include informal workers, its reach was limited by the exclusion of specific categories of workers.[20] As a result, a large proportion of South African informal workers such as domestic workers and seasonal workers were excluded from its reach.

The 2001 Unemployment Insurance Act and the 2002 Unemployment Insurance Contributions Act continued with a wide definition of 'employee' and removed the exclusions pertaining to domestic workers, seasonal workers and casual workers that existed in the 1966 legislation. They thus continued the trend after democratisation in 1994 of widening the net of protection of labour legislation to a much broader group of employees than before (see Benjamin (2008) and Olivier (2009) for an overview of some of the trends in labour legislation).

Both acts define an employee as 'any natural person who receives remuneration or to whom remuneration accrues in respect of services rendered or to be rendered by that person, but excludes any independent contractor'. The acts apply to all employees except those on learnerships, national and provincial government employees (at that stage), and people working for an employer for less than 24 hours per month.[21]

Given the large number of domestic and seasonal workers and the potential administrative problems with their inclusion, it was specifically stipulated that the Act would only apply to domestic and seasonal workers and their employers 12 months after the Act took effect. A specific body had to be appointed to make recommendations regarding the administrative aspects related to the inclusion of these categories of workers.

From 2003 onwards, domestic and seasonal workers were covered for the first time by the UIF. This entailed a significant expansion, as the two groups comprise approximately 25% of informal workers; as Samson (2009) indicated, domestic workers (around 1 million people) make up the largest single category of workers in South Africa (Samson 2009), and the great majority of them are black and are women.

A concerted effort was also made from 2005 (the time of a sectoral determination for taxi drivers) to ensure compliance by the employers of taxi drivers, who account for about 2.82% of informal workers according to Wills (2010).

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19 The 1966 Act defined a contributor as 'any person who has entered into or works under a contract of service or of apprenticeship or learnership, with an employer, whether the contract is expressed or implied, is oral or in writing, and whether his earnings are calculated by time or by work done…'

20 The 1966 Act specifically excluded casual workers, outworkers, short-time workers, domestic workers and seasonal workers.

21 While the 2001 legislation therefore expanded the potential reach of the UIF significantly, Benjamin (2008) points out some of the limits. He argues that the 'the coverage of South Africa's post-apartheid labour law regime is determined by a conventional definition of the employment relationship', which excludes the self-employed. While the statutory definition is broad he indicates that, 'while this definition is open to expansive interpretation, the Courts have traditionally interpreted it conservatively'.

4.5.5 Domestic workers

Many researchers hold that the inclusion of domestic workers in the unemployment insurance system has been successful (Samson, 2009; Olivier, 2009). As Samson (2009) points out, 'from 2003 to 2006 over half a million domestic workers registered with the UIF'. Figure 4.2 shows that the number of registered domestic workers has increased gradually since April 2009, reaching 653,528 registered domestic workers in March 2013. This would imply coverage of about than 75% of the estimated domestic workers of around 877,000.[22]

In addition to a large proportion of domestic workers being registered for the UIF, a significant number have also drawn benefits. Samson (2009) states that over 324,000 domestic workers had received UIF benefits by 2008, the majority of whom were women.[23]

However, household survey data could suggest somewhat lower coverage than the department's own numbers. Lund and Budlender (2009), utilising the 2007 Stats SA LFS, estimated that 32% of domestic workers contributed to the UIF.[24] Further analysis is required to determine whether this discrepancy relates to timing (and rapid increases in registrations after 2007) or to administrative data overestimating the extent of coverage, for example as a result of duplication of employee records.

There are, therefore, some questions about the actual extent of coverage of domestic workers, and benefit receipt and employee perceptions have not yet been analysed in any depth. Nonetheless, it is clear that, given the heterogeneity and complexity of the sector and given initial anticipation of administrative hurdles, the rapid expansion in coverage and accessing of benefits by domestic workers has been good.

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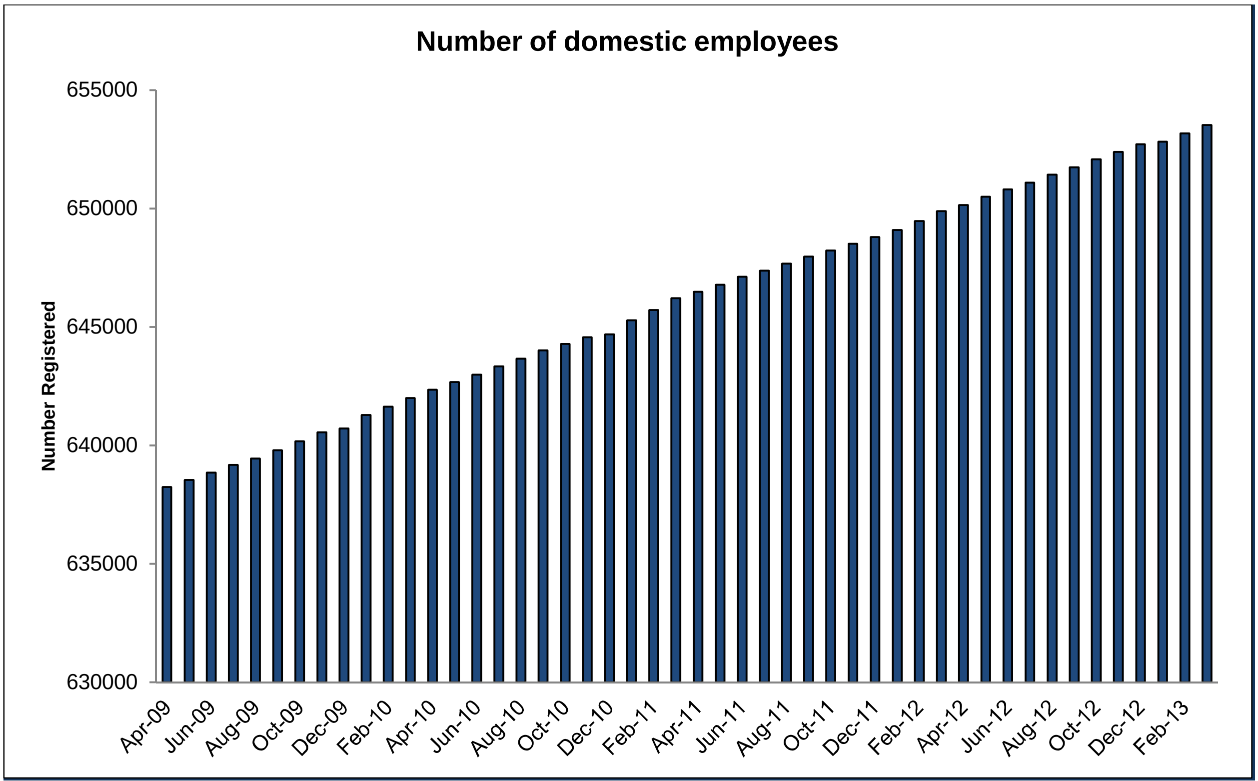
22 Estimate of domestic workers from the QLFS 2013Q1.

23 A data request was lodged with the UIF in May 2011 in order to secure data that would allow a more in-depth analysis of the contributions and benefits of domestic and other informal workers. These data have not been received to date.

24 Lund and Budlender (2009) show that, according to the 2007 LFS, 88% of domestic workers were women while 12% were male. Just over one-third (36%) had written contracts and 12% made contributions to pension funds. Only 2% of domestic workers were members of trade unions, and none had medical insurance.

Figure 4.2 Number of domestic workers registered for the UIF, 2009/10–2012/13



4.5.6 Farm workers

There is not much information about the registration of seasonal and farm workers with the UIF. In 2003, the Minister of Labour stated that approximately 50,575 farm employers and 569,000 farm workers had been registered with the UIF (South Africa, 2003).

4.5.7 Taxi drivers

While there is some evidence that there are increasing numbers of employers in the taxi sector, UIF registrations among these employers have been particularly low. The Department of Labour is attempting to increase taxi employer registration to the fund through information drives such as UIF roadshows for taxi employers. According to the 2012/13 UIF annual report, there were 6,857 employers registered in March 2013. Coverage of taxi sector employees is significantly lower than that of domestic workers. In March 2013, 6,184 taxi sector employees were declared as being registered with the UIF according to the UIF employee records.

4.5.8 Extension of the UIF to domestic workers: Ensuring compliance

Choi (2009) has suggested that 'the issue of the self-employed's pension is a matter of practical implementation rather than that of pension rules. The main problems are compliance and enforcement'. It could be argued that the same holds true for informal workers.

An instructive example is the early history of social security in the US, when domestic workers and farm workers were excluded from the contributory retirement scheme in 1935 on the basis of administrative concerns. DeWitt (2010) concludes that the exclusion was 'a policy promulgated by the bureaucracy to satisfy its own administrative needs'. In particular, 'subordinate officials in the Treasury, particularly those in charge of internal revenue collections, objected to such inclusive coverage on the score that it would prove administratively impossible to collect payroll taxes from agricultural workers and domestic servants'.

This was eventually supported by the then Secretary of Finance stating that, 'the bill in its present form imposes a burden upon the Treasury that it cannot guarantee adequately to meet. The national contributory old age annuity system, as now proposed … means that every transient or casual labourer is included, that every domestic servant is covered, and that the large and shifting class of agricultural workers is covered. Now, even without the inclusion of these three classes of workers, the task of the Treasury in administering the contributory tax collections would be extremely formidable. If these three classes of workers are to be included, however, the task may prove insuperable – certainly, at the outset.' He also argued that 'difficulties in enforcement would create incentives for these groups to become scofflaws, evading their taxes and thereby undermining the Treasury's mission' (DeWitt, 2010).

Many feared that similar administrative obstacles could hinder the inclusion of domestic workers in the South African unemployment insurance system after 2001. Samson (2009) argues that, 'the objective of covering domestic workers faced many challenges:

- ensuring compliance by households who employed domestic workers;
- managing a 20% increase in the number of contributors;
- developing cost-effective contribution management systems, particularly in light of the low value of incremental contributions.'

While there has been little detailed analysis of the mechanisms utilised by the UIF to ensure successful inclusion of domestic workers, and the detailed reports underlying the mechanisms developed were not available to us, commentators have identified a number of factors that contributed to its success.

Both Samson (2009) and Olivier (2009) highlight the importance of a 'sectoral' or occupation-specific approach, 'embedding tailor-made solutions, provisions and prescriptions for a particular group of workers in the informal economy' (Olivier, 2009). Examples of this in the South African case were the acknowledgement of administrative difficulties and the commissioning of research addressing those obstacles, as well as the inclusion of specific provisions taking into account the peculiarities of the sector. Olivier (2009) refers to the recognition of the reality of domestic workers having multiple employees (and therefore, for example, being allowed to claim benefits when there is only 'partial employment') and the fact that a domestic worker 'is entitled to unemployment benefits in the case of the termination of a worker's contract of employment as a result of the death of the employer.'

In addition, Samson (2009) pointed out that, '[p]ublicity, outreach and compliance mechanisms were developed in line with the challenges facing the associated employers' and the UIF 'developed procedures to minimise the administrative hurdles for employers'. These included the option of including UIF contributions with regular tax payments and 'an online electronic filing system for domestic and small businesses which significantly reduces the compliance burden and lowers administrative cost to the fund' (Samson, 2009). Payments could also be made annually where small amounts were involved, in order to reduce the cost of compliance.

Through the use of print media and television campaigns, awareness and understanding of the UIF among potential users was successfully raised (South Africa, 2010). The UIF itself has also suggested that the success of publicity among employers and employees may have led to less enforcement being necessary and that to some extent a self-regulating compliance mechanism has been established, which makes up for a lack of inspection capacity.

Benjamin (2008) concludes that 'a theme that emerges from all of these initiatives [to extend labour regulation to informal workers] is that there is no 'one-size-fits-all' solution to the regulation of informal work.' He adds: 'each individual labour right must be examined to ascertain whether it is feasible to extend it to particular categories of workers. Secondly, the highly sectorally specific diversity of informality makes it unlikely that national legislation applicable to all workers will provide regulatory solutions that are sufficiently nuanced for informal workers (Benjamin, 2008).

While the extension of the UIF to domestic and farm workers relies to a large extent on the ability ‘to locate a clearly identified employer who will comply with the statutory obligations of the employer’ … ‘[t]his is becoming an increasingly difficult issue in significant parts of the formal economy and in most of the informal economy. Workers may be located in complex chains of production in which there is no identifiable employer or work, particularly survivalist work, may be performed effectively for the worker’s own account’ (Benjamin, 2008). While publicity and compliance mechanisms in the case of domestic workers and the UIF could therefore be focused on a clearly identifiable employer, in other cases the focus will have to be elsewhere. In some sectors, there may have to be a focus on regulating the increasingly complex supply chains (e.g. seasonal workers in the horticultural sector, outworkers and home-workers), while other potential avenues relate to a focus on ‘incentives rather than sanctions’ through codes of good practice and certification of good business practices (Benjamin, 2008).

A similar occupational approach was taken in the case of informal taxi drivers in South Africa (Samson 2009), but little information is currently available on specific approaches and successes.

In addition to the need for a tailored approach, Olivier (2009) has also drawn attention to the ‘complementarity of the range of measures’ or ‘several interrelated measures… adopted in the space of a few years’, which contributed to the success of the UIF’s inclusion of domestic workers. The inclusion of domestic workers in the UIF followed on from the Basic Conditions of Employment Act 1997, which extended basic labour protection to domestic workers, and a 2002 sectoral determination for domestic workers that established minimum wages. This sectoral determination of domestic workers also highlighted the obligation of having a written contract in place, providing payslips and also providing information on conditions of employment and remuneration.

4.5.9 Consideration of the adverse effects of including informal workers in the UIF

There seems to be no analyses available in the literature on the impact on the employment and remuneration of domestic and farm workers because of their inclusion in the UIF. There is also very little available on the impact of the sectoral determinations. It is therefore exceptionally difficult to isolate the impacts of the UIF on domestic workers and other informal workers.

Hertz (2005) suggests that the advent of the sectoral determination for domestic workers in 2002 resulted in an increase of domestic worker earnings and a decrease in the hours worked by domestic workers per month on average. He further found that there was a rapid increase in the number of domestic workers who held formal contacts with their employers and that UIF uptake, although slow, was increasing for domestic workers. Hertz (2004) provided evidence that the increase in domestic worker registration for the UIF and the increase in the number of domestic workers earning above the minimum wage was not coincidental, but was rather the effect of regulation (Hertz, 2004). However, it was noted that there was not much progress with respect to the payment of UIF benefits made to domestic workers at that stage, most likely due to the short time lapse between implementation and the study.

While there is therefore no direct evidence on the impact of UIF inclusion and the indirect evidence on the effect of labour regulation on employment is limited,[25] and now dated, there has been no vindication of the pessimistic position that incorporation of domestic workers would see dramatic negative adjustments in the labour market or evasion on a large scale.

25 Two small regional studies have been carried out reporting a negative impact of the extension of labour protection on employment. However, these results, pointing to job losses in specific areas, cannot be generalised due to the small geographic focus and also because they rely on small surveys, the quality of which cannot be assessed easily.

4.6 Some administration and fund management considerations in designing pension systems for informal workers

An important consideration in pension systems relates to the administrative structure of the system. Systems that have high administrative costs generate smaller net investment during contributors' working lives and ultimately decrease the level of benefits received by those contributing to a scheme (Sandoval, 2004). While this consideration is important for any pension scheme, it is particularly important for mandatory schemes and even more so when attempting to include informal workers in an individual account system, given that they are likely to contribute smaller amounts into a system. Smaller contributions increase transaction and administrative costs. At the same time, however, this increases the importance of reducing overall costs for two reasons. First, it raises equity concerns for low-wage workers. Those who are only able to make small contributions into a system should be protected against the danger that all or most of their contributions could be eroded away by charges, with only those paying larger contributions seeing any investment and return from their contributions (World Bank, 2000). Second, higher administrative costs (and the consequent lower benefits) create an incentive to evade the system (Sandoval, 2004). If a system is to remain attractive in encouraging voluntary participation by those in the informal economy, innovative design options will be needed to control for overall administrative costs, particularly when inclusion of informal workers is likely to put upward pressure on these costs.

A number of options exist and have been experimented with in order to decrease overall costs in national pension systems. Studies have found that significant cost reductions can be achieved through economies of scale, as pension systems tend to have high operating overheads (ECLAC, 2006). An important way in which these economies of scale have been exploited has been through centralising collection, reconciliation and administrative functions such as recordkeeping in a central clearing house. Systems in Sweden and Mexico have both seen reductions in transaction costs as a result of the centralisation of administrative functions in one agency (Shah, 2005). Apart from reducing overall costs, centralisation of functions has other advantages too. It helps to simplify the system and is assumed to increase competition in fund management. Users of the system have one point of contact with both information relating to fund performance and with the authority to switch funds for those who wish to do so, which increases the ease with which clients are able to switch to better-performing funds. Another important means of reducing costs relates to the use of IT systems that decrease transaction costs related to small contributions and small-value account balances. Efficient systems that minimise these costs will be particularly important and new technology can play an important role in achieving this (Shah, 2005). The number of small-value transactions paid into the system could also potentially be decreased by allowing quarterly or annual payments (instead of monthly payments) for those only able to make small contributions.

Cost reductions can also be created through the design of the fund management structure. A trend in a number of countries (particularly in Latin America and some eastern European countries) has been that of deregulation and privatisation of pension systems. This has involved a move away from publicly managed unfunded schemes to privately managed funded schemes in an attempt to improve the management of funds and decrease costs (Palacious and Pallares-Miralles, 2000). Using privately managed funds helps remove them from political interference. Schemes in Asia and the Pacific that had funds managed in-house were found to be subject to political interference and were consequently characterised by low returns (Palacious and Pallares-Miralles, 2000). World Bank research has also found that public management has typically led to low returns (World Bank, 2000). However, simply privatising fund management is not enough, as the system also needs to be designed in a way that allows for and encourages cost reductions. The Latin American experience shows that, although privatisation increased competition between fund managers, this competition did not translate into cost reductions for customers as competition was not focused on the most important variables (price and returns) and gains in efficiency and costs were not passed on to those in the pension system (ECLAC, 2006). It is therefore important that the design of the system encourages effective competition that translates into a reduction in costs that benefits the users of the system.

Various suggestions have been made in terms of how the design of the system can encourage this. One suggestion has been that of using a competitive auction process to identify and appoint fund managers with the lowest consolidated pre-committed fees and expenses to ensure that the fees are kept low from the outset (Shah, 2005). The Bolivian government used this process and auctioned the rights to manage its pension funds internationally. Fund managers were assessed predominantly based on the size of their proposed fee and two were chosen and given a five-year duopoly guarantee. This process has kept charges low in Bolivia (World Bank, 2000). Regulation of charges or of transparency in charges can also play an important part in ensuring that administrative charges are kept low (World Bank, 2000). Another suggestion has been that of a mandatory use of a specified level of index funds (Shah, 2005), as these funds require little management and incur minimal administrative costs. However, this needs to be balanced with the need for diversification of investments for funds. Experience in terms of regulation of funds has shown that the focus should be on the quality of the funds invested in rather than specifying the asset classes to be invested in. Diversification, and in particular international diversification, is important to ensure that fund managers have access to a variety of asset classes, so any minimum mandatory levels of particular asset classes need to factor in these considerations.

Further design suggestions have been made to allow for a limited level of choice in funds for those incorporated into the system in order to exert competitive pressures on fund managers and give contributors some choice in their investments while still keeping the system fairly simple (Shah, 2005). These suggestions have been made for the reform of the Indian pension system and take into account the high levels of informality in employment as well as the low levels of financial literacy in the country. They should therefore be applicable in other developing country contexts too. The suggested design is that of a simple framework through which individuals are able to choose between multiple fund managers and multiple asset classes. The range of portfolio choice should be kept small to ensure that this does not translate into increased transaction costs or become too complicated for users. The proposed suggestion is that of a system with three standardised product types (each with varying levels of risk according to the choice of asset classes) and a limited number of fund managers (around three to six). If, for example, three fund managers were chosen, this would result in a choice of nine funds with a 3 x 3 table of performance that can be easily understood and interpreted by those included in the pension system. The system would remain fairly simple but would allow people to choose according to their own risk preferences (which vary at different ages), with various options in terms of fund managers and the right to switch to their preferred product type and fund manager. The choice introduced into the system is expected to translate into increased competition in the fund management system, which should ultimately translate into cost reductions and improved performance without introducing too much complexity into the system (Shah, 2005). Research on administrative charges by the World Bank in 2000 of 15 pension schemes across the world showed that the three systems with the lowest charges were those offering a limited choice of provider and/or investments (World Bank, 2000).

4.7 Conclusions

In conclusion, this chapter shows that extending social protection to informal workers is fraught with challenges, some to do with the demand side of the extension (the workers) and perhaps many more to do with the supply side (the kind of protection offered). In cases where the scheme meets the needs of those targeted, given adequate information on and awareness of the scheme, the levels of contribution to social protection increase. In Chile, for example, many years of offering schemes to vulnerable workers have resulted in the country boasting one of the highest rates of informal worker coverage in the world.

This chapter also highlights the need to create bespoke, innovative solutions that are specific to the country in question and the nature of the informal workers targeted. In Tunisia, challenges in extending social protection required in-depth knowledge of the levels of earnings among informal workers, while in Kenya the use of technology (mobile phones) made it possible to extend social protection to informal workers.

In South Africa, the UIF is a working example of how extending social protection to those that have vulnerable employment can work. In the 2012/13 fiscal year, the scheme had over 700,000 beneficiaries, underscoring the reach it has had in the South African labour market. Despite the many challenges, social protection can be extended successfully to informal workers and there are a number of examples from around the world that highlight the potential benefits of doing so.

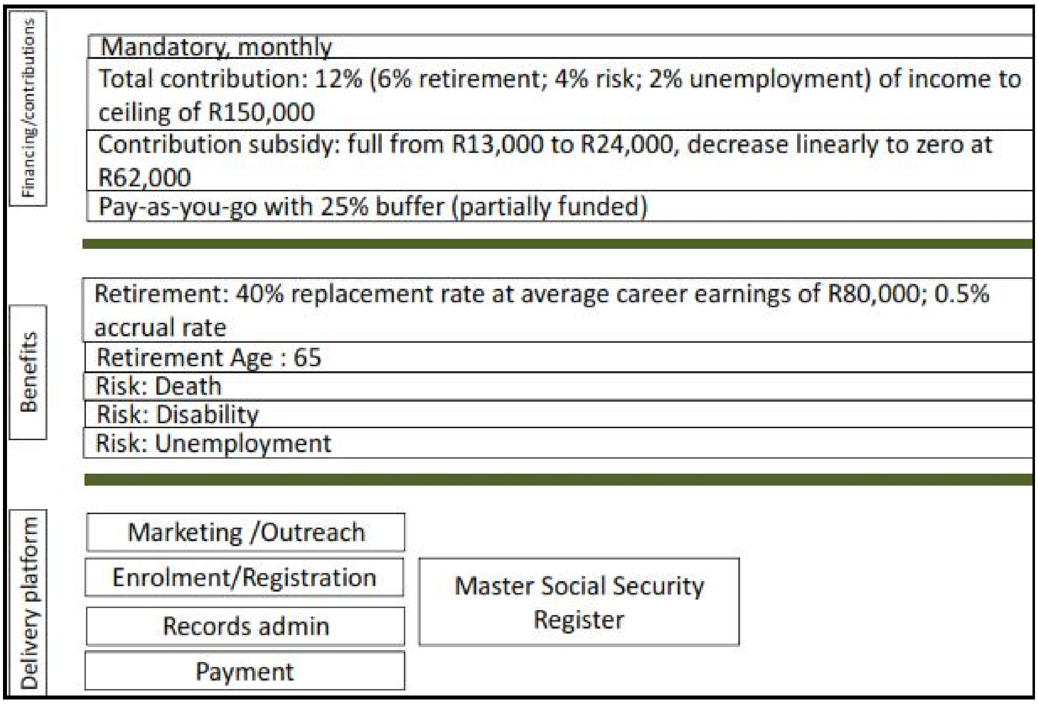
5 Informal worker responses to government's proposal for a mandatory contributory retirement scheme

This chapter aims at supplementing existing research on informality and social protection in South Africa and aims at improving the understanding of two important areas. The first aim is to understand the current circumstances of those in informal employment and how they think about provision for retirement. The second is to allow for testing of the response of informal workers to a proposed system of retirement contributions and inputs from informal workers on the design of the system to ensure their inclusion. The investigation of these themes was conducted through FGDs and KIIs. The chapter starts by providing a high-level summary of the current proposal to include formal workers in a mandatory provision-for-retirement system. Results from the FGDs and KIIs are then discussed, and key elements from each highlighted in the conclusion.

5.1 Government's proposal for a mandatory contributory system for formal workers – rationale and design

The South African government, as part of a broader set of social security reforms, intends to introduce a mandatory statutory fund that provides pension, life insurance and disability benefits (National Treasury, 2012). The rationale for the reform is that too few South African save adequately for retirement; the NT estimates that only 'about half' of employed people belong to a retirement fund and that only 10% of South Africans have levels of savings that are adequate to maintain their living standards into retirement. The statutory fund is intended to address some of the shortcomings of the current retirement environment, including the essentially voluntary nature of the current system, the high level of withdrawals before retirement, high fund costs due to the large number of private sector funds, and low levels of annuitisation (National Treasury, 2012).

Figure 5.1 Outline of proposal for National Social Security Fund



Source: the Interdepartmental Committee on Social Security Reform in 2010

The broad design of the statutory National Social Security Fund (NSSF) was set out in a set of documents from the Interdepartmental Committee on Social Security Reform in 2010 (IDTT-SSRR 2010a and b).

The fund will target all workers earning more than the value of the SOAP, which amounted to R13,000 in 2010. Workers earning less than the SOAP will be adequately covered in retirement by the SOAP – and would struggle to contribute to a fund. The scheme will be mandatory for ‘all working South Africans above a stipulated earnings threshold’ (IDTT-SSRR 2010a)

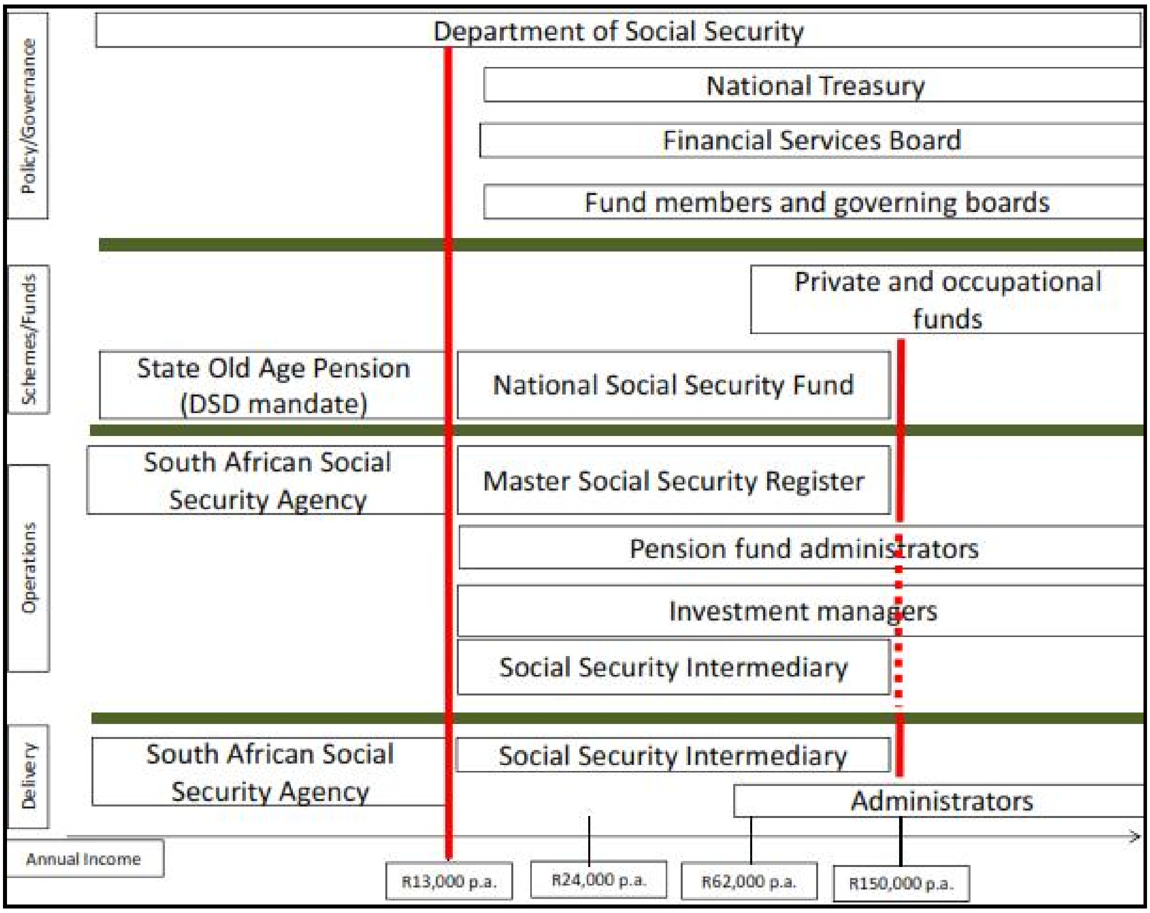
Most recent documents (National Treasury, 2012) state that pension, life insurance and disability benefits will be provided. It is realised that successful preservation will depend significantly on complementary unemployment insurance provisions. ‘Government-underwritten guarantees for those participants who need them the most’ are also proposed. Retirement benefits will be determined on the basis of career salary, years of contribution and an accrual rate. The proposed contribution rate for retirement would provide a replacement rate of 40% for those with average career earnings of R80,000 (National Treasury, 2010a). For projection purposes, an accrual rate of 0.5% was used

Contributions are to be based on earnings. The income ceiling for the calculation of contributions will be the same as the UIF contribution ceiling (R150,000 in 2010 terms) (determination, income ceiling, total and distribution). Contributions of 10% of earnings (with 6% funding retirement benefits and 4% for risk benefits: death and disability) have been proposed. The 2% contribution to the UIF will continue.

Wage, contribution and tax breaks are under consideration. In projections, a full subsidy from tax revenue between earnings of R13,000 to R24,000 was assumed and then linearly decreased to phase out at R62,000. The proposal sets a retirement age of 65 years.

Administratively, an integrated structure for the governance and administration of social security is proposed. The current range of social security funds is to be integrated into the NSSF to administer retirement, death and disability benefits and to manage the assets of the fund. Client interaction will be through the Social Security Intermediary and a Master Social Security Register is proposed ‘to consolidate personal information relating to members and beneficiaries’. A Department of Social Security is proposed to oversee policy and the strengthening and extension of the reach of the pension regulator to also oversee statutory funds. Consideration is being given to reducing the administrative load on the NSSF through opt-out arrangements given the satisfaction of certain criteria. With regard to asset management it is suggested that this should not be centralised in the hands of one organisation and reference is made to the Chilean model (workers select from among competing funds) and the ‘private/Japanese model’ (contracting out asset management to several different independent managers).

Figure 5.2 Overview of national retirement and risk benefit system.



Source: the Interdepartmental Committee on Social Security Reform in 2010

Based on this proposal, FGDs and KIIs with individuals in informal employment (and their representatives) were conducted to explore if a similar scheme would potentially work among informal workers. The results of the KIIs are presented below.

5.2 Key informant interviews

5.2.1 Introduction

KIIs were conducted with key people from 13 organisations that represent informal workers in a number of industries across different sectors in South Africa. The list of organisations for which KIIs were conducted with representatives, as well as the type of institutions involved, is presented in Table 5.1. The aim of the KIIs was to gather information on the number of informal workers represented by the respective unions/organisations, and gather any relevant information about the main characteristics of the union/organisation members. The KIIs would also assist in understanding informal workers more directly in terms of what the incomes for those members are, if any of the unions have provision for retirement, and what roles the unions or representative agencies could play in assisting with the provision of the informal workers' scheme. The KIIs were used as a platform to also probe the perceived importance of the provision for retirement.

Table 5.1 Name and type of institution for which KIIs were conducted

Name of institution	Type of institution
Arterial Network (AN)	Network
Food and Allied Workers Union (FAWU)	Trade union
South African Transport and Allied Workers Union (SATAWU)	Trade union
Creative Workers Union of South Africa (CWUSA)	Trade union
National African Farmers Union (NAFU)	Network
South African National Taxi Council (SANTACO)	Employer bodies
AGRI SA	Employer bodies
South African Football Players Union (SAFPU)	Trade union
Women on Farms Project (WFP)	Not for profit
Absa (Home employees, Agricultural Sector and Small Business Provident funds)	Not for profit
SAMRO	NPO enterprise
South African Domestic Service and Allied Workers Union (SADSAWU)	Trade union
Gauteng Sports Council (GSC)	Government entity

5.2.2 NAFU

5.2.2.1 Organisation and its objectives

NAFU is a politically non-aligned body for farmers that was formed in 1991 as an agricultural committee of the National African Federated Chamber of Commerce (NAFCOC). Its membership is mainly subsistence farmers from the former homelands, rural farming communities, and those who farm on township commonages.

Its main objective is to promote and encourage the development of small black farmers in South Africa and assist them in getting their produce into the existing commercial markets. A key objective of NAFU is to build institutional capacity among smallholder farmers. NAFU's focus is primarily to educate farmers about the use of land, crop care and livestock wellbeing, which includes inoculations, etc. Most farmers who are members of NAFU are beneficiaries of grants and land emanating from the land restitution process.

NAFU also plays a role in lobbying for land, finance and water on behalf of emerging farmers who do not have the skill or know-how to engage with stakeholders to negotiate their needs.

5.2.2.2 Membership

NAFU has around 4,500 members on its database and relies on the annual membership fees of R550 (R46 per month) paid by its members, as well as subsidies from NAFCOC. Members sometimes struggle to pay the annual membership fees to NAFU and, in certain cases, arrangements are made to pay off the amount due in instalments.

These farmers also face many challenges, including limited access to finance as well as exposure to the commercial markets. The production of smallholder farmers is normally small and therefore it is difficult to obtain long-term contracts with larger companies. Commercial banks are also reluctant to assist rural and emerging farmers because of the nature of their business.

5.2.2.3 Social protection benefits and challenges in extending provision for retirement

Very few NAFU members have personal insurance that covers disability, death and retirement or even health insurance. In most cases, this is either because members cannot afford to pay such premiums monthly, as it is seen as a luxury and not a necessity, or because of the general lack of education and poor financial literacy of these farmers.

The priority for most members is funeral insurance, and sometimes they have more than one funeral insurance package through different brokers or companies, although this does not always make sound saving/investment sense.

NAFU members are banked through one of the existing commercial banks.

5.2.2.4 Potential uptake of retirement scheme

The proposal for a government sponsored retirement fund was received very well by the president. As previously stated, this sector faces many challenges and therefore this type of social protection system could be very beneficial to NAFU members. Members would be very keen to participate in such an initiative as long as it was subsidised in some way by government and did not rely solely on member contributions.

NAFU would be in a position to recommend this proposal to its members once it receives more clarity on what exactly the proposal involves and what the benefits to members would be.

They had no particular preference for government or private sector benefits, as no concrete proposal had been put forward at this stage.

5.2.2.5 Potential role NAFU could play

NAFU was willing to play an advocacy role to inform members about the proposed system, but would require some sort of assistance from government to reach out to members as they already struggle with financial resources for the day-to-day administration and operations of the organisation. They do have a database of members and they would therefore gladly assist in collecting contributions and in paying benefits to members if this was in the best interests of NAFU members.

5.2.3 SAMRO

5.2.3.1 Organisation and its objectives

SAMRO membership comprises southern African composers, authors, and music publishers. SAMRO was established as a company limited by guarantee in 1961 and, while not strictly a 'not-for-profit' company, has delivered its services to its members on a not-for-profit basis. SAMRO's objective is to protect the intellectual property of composers and authors, as well as to ensure that composers and authors' talents are adequately credited both locally and internationally for music usage. The organisation is the primary representative of music performing rights in southern Africa. As such, SAMRO is affiliated to most global collecting societies for public performance or mechanical reproduction rights, who administer performing rights on behalf of SAMRO in their countries. SAMRO represents in excess of 12,000 South African members and over 1.4 million composers across the globe.

SAMRO plays a vital role in the administration of works and the distribution of royalties, also providing copyright protection for composers and authors' works through the collection of licence fees from television broadcasts, radio stations, in-store radio stations, pubs, clubs, retailers, restaurants and all other businesses that broadcast music. Today, SAMRO has grown into an internationally recognised collecting administration business representing more than 12,000 music creators. It has built up a solid reputation as the primary representative of music performing rights in southern Africa, and is well respected among its global peers as a leading music rights society.

SAMRO employs 200 people to deal with the day-to-day running and administration of the organisation. Of these 200 employed, only 180 are members of the Provident Fund. SAMRO contributes between 17% or 18% to the fund, which according to the Financial Services Board means they are underfunded by about 3%.

5.2.3.2 Membership

In terms of estimated numbers presented to the interviewers, only about 300 members earned more than R20,000 a year. The rest of the members earn less than this a year. There are about 6,000 members applying for membership to SAMRO who have either written or composed music but who have not yet had any airtime, and this therefore means that they are not yet eligible for membership. SAMRO has a membership growth rate of about 1,000 members a year.

The revenues of SAMRO are getting smaller, even though the organisation's membership base is growing. This is because they have difficulty in keeping track with members who often move around the country and do not keep their membership records updated. SAMRO does, however, try to constantly keep in touch with their members through text messaging, emails and snail mail. Indeed, it even encourages members to use a 'please call me' option if they have no means of contacting SAMRO etc. so as to keep members updated and informed.

The typical members of SAMRO are self-employed, rural-based Maskandi musicians who are poor and use their creativity as artists or performers as a business to generate some kind of income. SAMRO has recently set up contact centres in some provinces to facilitate communication with its members or aspiring members. The centres have been set up in Limpopo, Eastern Cape and Durban. The one operating in Limpopo is in cooperation with a community centre and provides forms and other services and information to the community. The one in the Eastern Cape operates from the Mariam Makeba centre in East London. Furthermore, an online web portal also exists to keep in touch with members.

All members are banked and this process was facilitated with Absa. This makes administration much easier as cheques were stopped in 2007.

5.2.3.3 Social protection benefits and challenges in extending provision for retirement

Of the 12,000 members SAMRO has, only 7,000 members belong to the fund (58%). The reason for this is that only natural persons can become members of the fund and corporate members (publishers) cannot belong to the fund. As a member of SAMRO, whether you earn royalties of 1c or R 1 for the year, the contribution of R800 is still paid by SAMRO toward the fund.

The fund is non-contributory for members, but SAMRO makes a single annual contribution to the fund on behalf of the members. The contribution is allocated to the individual members in the following manner:

- any member who has earned royalties from SAMRO in the year in which the contribution is made will receive a basic allocation of R800 annually; and
- any monies left over after the initial allocation is done are then allocated to the members in proportion to their individual South African performing rights royalty earnings.

The heirs of members of SAMRO cannot belong to the fund. Members can elect to retire from the fund once they have reached the age of 55, but retirement is compulsory once a member reaches the age of 75. If a member withdraws from SAMRO as a member, they cease to be members of the fund and their benefits have to be paid out to them. As a rule, exits are only processed for retirements or death, otherwise normal pension fund benefit allocation rules are applied. The fund is a unique hybrid of a traditional retirement annuity fund and a pension or provident fund.

These contributions are funded from SAMRO's social and cultural retentions, which are made in terms of the Confederation of International and Societies of Authors and Composers (CISAC) rules that govern copyright administration organisations around the world. The vast majority of overseas composers are party to the CISAC agreements with American, Belgian and British organisations. In terms of these agreements, a portion of net South African performing rights licence revenue may be retained by a copyright organisation for use for social and cultural purposes. The cultural projects include focus on the development of music, which includes the awarding of bursaries to talented musicians from disadvantaged communities. The SAMRO Foundation administers this fund. The social initiatives fund is made up of the SAMRO Funeral Benefit Scheme and the SAMRO Retirement Annuity Fund (SRAF). According to agreements made with individual organisations, between 5% and 10% of net South African performing rights revenue may be retained by SAMRO.

At present, the funding model for SRAF is in a state of flux. The recent implementation of the new Companies Act has converted SAMRO from a public company limited by guarantee to a non-profit company, as its previous corporate status was not catered for under the new act. SAMRO, as a member-based organisation without share capital, cannot therefore convert to a for-profit company. In terms of the new act, a non-profit company cannot make distributions to members, although an exception has been made under schedule 1 that allows for the distribution of royalties to members. Payments such as the SRAF contribution does fall under this exception, according to the organisation's legal advisers. SAMRO is currently exploring options that would enable it to continue the contribution, but under the current circumstances the contribution to the fund by SAMRO on behalf of its members is not an option. When members were consulted about the possibility of the rule being amended to have members pay directly into the fund, members responded negatively. The typical response was, 'you mean you want us to pay from our own money?' Subsequent to this discussion, some members have opted to leave the fund.

5.2.3.4 Potential reception of government proposals

A large number of members are poor and with lower levels of education and financial literacy, and sometimes they seem to have more than one funeral plan and pay to many '*stokvels*'. This means that they are paying large sums into some type of funeral or other form of saving that does not always yield the best returns.

Members do not always understand how the fund operates and at AGMs have asked questions like, 'can the fund be used as security for a home loan?'.

5.2.3.5 Potential role SAMRO could play

SAMRO does have education forums and these could be used as a platform for the rolling out of the scheme once the government plans are at a more advanced stage. The organisation may also be in a position to assist with payments to members as it has a large, relatively well maintained membership database.

5.2.4 AGRI SA

5.2.4.1 Organisation and its objectives

AGRI SA, a federation of agricultural organisations, was established in 1904 as the South African Agricultural Union and consists of nine provincial and 28 commodity organisations. Essentially, AGRI SA through its affiliated membership represents a diverse group of farmers, regardless of gender, colour and creed.

AGRI SA's primary role is to influence policy on a national and international level. The policy advocacy work they focus on includes financing, land reform, labour laws, training and development, as well as addressing the stability and sustainability of commercial agriculture in South Africa.

AGRI SA is also a member of a business, trade and agricultural network, which includes Business Unity South Africa, the International Chamber of Commerce, the World Farmers' Organisation, the Southern African Confederation of Agricultural Unions and the Cairns Group Farm Leaders.

5.2.4.2 Key issues in relation to farm workers and employment on farms

The seasonality of farm workers' work creates certain challenges for farmers as it creates a level of instability that entails farm workers sometimes moving to different farms or different provinces dependent on harvest and picking/packing times, etc. There is also a high rate of workers absconding and this creates enormous challenges for farm owners in terms of keeping track of their employees. Many foreign workers are also employed on certain farms and they are employed in labour-intensive (including fruit, sugar cane and forestry) and other specialist industries (wool) as seasonal workers. In some cases, these foreign workers are in the country with legal documents and, in other cases, farm owners sometimes have great struggles to secure corporate permits to allow the employment of foreign workers. AGRI SA was involved in discussions regarding possible changes to immigration legislation and facilitated meetings with the Department of Labour regarding the issuing of permits.

A very small number of farm workers in the agricultural sector belong to a union; it seems that below 10% of farm workers that work in bigger farmer are unionised (estimate from interviewee). The existing relationship between farm owners and organised labour is not cordial and that is why AGRI SA is in the process of trying to sign memoranda of understanding with the Congress of South African Trade Unions (COSATU) as well as FAWU. AGRI SA is also in discussions with the ILO to address building working relationships with the trade union movement.

5.2.4.3 Membership

It is not possible for AGRI SA to provide specific details on the number of farm workers and their income levels because of the various sectors and categories of farmers and workers that form part of AGRI SA. There are seasonal workers, temporary workers, labour-brokering practices and other atypical employment relations that exist and therefore no exact information can be given.

5.2.4.4 Social protection benefits and challenges in extending provision for retirement

AGRI SA in cooperation with Absa Consultants and Actuaries are offering participating employers a provident fund to provide for their employees with retirement and risks benefits. The Agricultural Sector Provident Fund provides retirement, withdrawal, death, disability and funeral benefits. The fund comprises several plans, each offering unique benefits at affordable monthly contributions that are linked to the sectoral determination of wages for farm workers.

The member’s fund value is based on the net contributions saved after the deduction of the cost for administration, death, disability and funeral cover. The fund value depends on the level of contributions, growth and the term for which the contributions are made. The savings term of members who join the fund at an advanced age is shorter than that of younger members, so their fund value at retirement will also be lower.[26]

There are currently 14,000 farm workers in the fund and most of them are on the first three plans the fund offers (i.e. A1, A2 and B) because the monthly contributions are affordable at these levels.

AGRI SA members do not support the Department of Labour’s proposal to create a statutory provident fund for farm workers. They do not want government to privatise these funds as they are concerned that this statutory fund will increase costs substantially.

5.2.4.5 Potential uptake of retirement scheme

As stated above, AGRI SA would be opposed to a government fund if proper mechanisms are not put in place around good governance, accountability, and oversight of the growth of funds and how they are managed.

There would need to be buy-in from the farmers before they could reach the stage of promoting the fund among farm workers. AGRI SA would need to understand the working of the fund and how it would be subsidised. They would furthermore be keen to see some kind of a public–private partnership arrangement in order to realise a fund that would suit the needs of its members.

5.2.4.6 Potential role AGRI SA could play

AGRI SA would be willing to play a role in terms of information and advocacy among its members and farm workers. They believe that this initiative could strengthen the existing sector fund, but would be concerned if the fund was mandatory for its members as this might create resistance from some quarters.

5.2.5 FAWU

5.2.5.1 Organisation and its objectives

FAWU is a trade union affiliated to the COSATU. The union’s core business is recruiting and servicing its members, as well as bargaining with employers on conditions of employment on behalf of its members.

The core business of the union is divided into representation, which includes grievances, disciplinary action and legal appeals on behalf of its members. A second area is collective bargaining, which involves negotiating on behalf of members on such issues as wage increases, working conditions and benefits.

FAWU has had trouble organising its members on farms, in forestry and in the fishing industry. The challenge in these particular sectors is that the working conditions are not always favourable and workers are sometimes intimidated into not joining a union by their employees. Moreover, only a handful of workers in these sectors have contracts with their employers, as the people who are employed are normally seasonal or temporary workers.

FAWU has provided a funeral benefit for members of R5,000 per member since April (2013). This benefit comes from the FAWU coffers. The system existed in the past, but was abandoned in 2002 after certain

26 Agricultural Sector Provident Fund – Information Pamphlet issued by Absa.

complications were experienced. Since April, however, it has been working well and members have been grateful to the union for this benefit.

5.2.5.2 Membership

FAWU has a current membership of approximately 127,000 people. The membership is divided into categories, including: farms; sea fishing; food processing; beverage manufacturing; food merchandising; and the hospitality industry.

The lower earning members earn R2,100 per month, with the upper scale being R30,000 and the middle earners earning around R5,500 per month. The monthly membership fee is proportional and dependent on the member's monthly salary, and could be anything from R35 to R120.

Most members have an amicable relationship with their employers but, as previously stated, the vulnerable workers in the farming, fishing and forestry still experience many serious challenges.

5.2.5.3 Social protection benefits and challenges in extending provision for retirement

FAWU has a funeral scheme through Safrican (insurance company) to which employers make contributions for about 9,000 of its members. The cost to the employer for each member is R45.70 and the benefit is R20,000 for the funeral costs of a member. Workers do not typically have social protection benefits, but if they do funeral insurance would be the first priority. Death cover, disability, work accidents and retirement would take priority in that order.

A large percentage of FAWU members are banked, but there would also be a percentage that fall into the vulnerable sectors mentioned above who are perhaps paid daily or weekly and would therefore be unbanked.

5.2.5.4 Potential uptake of retirement scheme

The FAWU interviewees believe that this proposed social protection system is a very positive step by government and is something that will excite FAWU members. They are, however, of the opinion that this system will only succeed if some sort of legislation exists to make it compulsory for employers to take care of workers through this fund.

The feeling of the general secretary is that members would welcome this type of fund as many of its members are prepared to do this on their own but would appreciate employers and government contributing a core part of such a contribution on their behalf.

FAWU would require more information to be able to advocate such a system to its members and would appreciate it being a public–private partnership.

5.2.6 SADSAWU

5.2.6.1 Organisation and its objectives

The SADSAWU was launched in response to the reality that the existing labour laws, introduced by the new democratic government of South Africa, did not extend to cover domestic workers. SADSAWU therefore felt there was a need to create a strong and viable union for this sector, which is one of the most exploited, so as to ensure that not only were the rights and demands of domestic workers met but also to guarantee these vulnerable men and women a voice in the drafting of future labour legislation that will include this sector.

5.2.6.2 Membership

SADSAWU has had trouble in recruiting members. The biggest challenge stems from the LRA prescription that a union must have the permission of the employer to organise on their property. The union therefore cannot develop its presence in the sector because workers are too atomised. Currently, the union has 1,000 (paid-up) members, although its records indicate that they have many more members than this. The organisation is in the process of trying to create an active database to track membership more effectively.

The membership fee is R10 per month. SADSAWU is also trying to set up an employers' body and once that is set up SADSAWU will then try to get employers to deduct membership fees from wages. The average income for workers, per eight-hour day is around R50.00. The sectoral wage determination in place stipulates a minimum wage of R1,740 per month, but the ability to enforce this is limited and so employers often undercut this minimum threshold.

The typical earnings and conditions are that a labour-brokering firm (agency) will pay R1,740 per month but workers may work in three different houses for one month's salary. Daily workers earn the same as live-in workers but daily workers have to pay for their own transport. Wages in the industry are also differentiated, with those in urban areas receiving slightly higher wages than those in the rural areas. At the time of our interviews, these rates were R9.20 per hour in urban areas and R8.10 in rural areas

Contracts are often verbal and written contracts can be changed to meet both parties' needs. Some employers do abide by the sectoral wage determination, although many members do not understand the legislation.

5.2.6.3 Social protection benefits and challenges in extending provision for retirement

In general, members have access to the UIF and to work-related accident compensation (through Compensation for Occupational Injuries and Diseases Act (COIDA)) and some have a form of medical cover that allows for 36 paid sick days over a 36-month rolling cycle. There are practical challenges to ensuring members have the prescribed benefits. Although about 600,000 workers are registered on Department of Labour database as receiving UIF, there are no fines for employers who do not register their employees and the database is not kept up to date.

The UIF does not work very well for domestic workers because many do not receive payslips. This causes problems when services are terminated, as the employee must get a signed document affirming that they have worked for at least three months.

5.2.6.4 Potential uptake of retirement scheme

Members would ideally want to be part of a retirement fund. However, some reassurances are needed as this is not the first time such a proposal has been mooted. There was a domestic pension fund pioneered by Thabo Mbeki and Gloria Serobi that no longer exists, and it was not compulsory for employers to contribute toward this fund. For the pension scheme to be attractive, the government must ensure all employers are a part of the new fund.

Workers will also need to understand how the fund will be managed. The fund will have to cater for all precarious workers. Moreover, the government will have to provide various options so as to ensure domestic workers can make an informed decision.

5.2.6.5 Potential role SADSAWU could play

SADSAWU would advocate this fund on behalf of all domestic workers if the policy is explained and government provides different options for workers to better allow them to make their decision.

5.2.7 WFP

5.2.7.1 Organisation and its objectives

WFP works with women workers and farm dwellers in the Western and Northern Cape. WFP strives to strengthen the capacity of women who live and work on farms to claim their rights and fulfil their needs in terms of the South African Constitution. The organisation offers socio-economic rights-based training, research, casework, advocacy and lobbying. The programmes they offer include:

- Cooperatives and food gardens;
- Health and empowerment;
- Labour rights;
- Land and housing; and
- The Northern Cape Young Women's Programme.

For most of the families they work with, the sector minimum wage is not enough to provide for a family. Major of members are seasonal workers do not earn enough as seasonal workers and many live on the child support grant between seasons.

Women are temporary seasonal workers considered general workers. From season to season, women work for different farm owners. The labour broker (who is a former farmworker and unregistered labour broker) recruits a group of women for a season. Contracts amongst seasonal workers are not formal written contracts. Many women work based on a verbal contract. Part of WFP training programme is to ensure women have a written contract.

The legal wage per day is R105. This wage also depends on where workers live. In the backlash by farmers after the 2012 strike, workers find that the on-farm deductions are greater. Now workers have to pay rental for the house, electricity costs have increased and a tenant must pay rental for any child over the age of 18 years. Many of the changes are illegal but if a worker is unaware of his/her rights, they will comply with the employer. Firewood is no longer free. Transport by the farmer to the nearest town for shopping on a Saturday is now paid for. Therefore, the farm worker who does not live on the farm earns more than those living on the farm.

5.2.7.2 Membership

WFP is not a membership-based organisation and instead offers services on demand. It is therefore difficult for the organisation to give accurate estimates of the number of women they have assisted.

5.2.7.3 Social protection benefits and challenges in extending provision for retirement

Most farm workers do not have a pension or provident fund. Although most employers register employees for the UIF, access to the offices is difficult. In most cases, women have to travel long distances to access forms, return to the farm to have the document signed by the owner, and then once again go back to the offices[27]. The transport costs are exorbitant because there is no public transport and farm workers have to walk to the nearest road. Another challenge is that many workers are not educated on their rights as UIF members and often do not know what to do (to access their benefits) when they resign or there is an unfair dismissal

5.2.7.4 Potential uptake of retirement scheme

WFP will support the uptake of the pension plan because although the current state pensions do provide a reasonable income replacement ratio, current incomes do not provide for a decent standard of living. Even though access to the UIF has improved retirement prospects, the UIF payout is also far too small. The UIF also excludes a significant number of women farm workers who are employed on a seasonal basis.

Generally, government commitment to subsidise/match contributions will be a welcome incentive for farm workers

5.2.7.5 Potential role WFP could play

WFP has previously tried to implement a social protection programme for workers, but the programme ran out of funds. The organisation is willing to assist in any way possible, as long as there is enough support among its members.

5.2.8 SATAWU

5.2.8.1 Organisation and its objectives

SATAWU came into existence on 18 May 2000 after a series of negotiations and smaller-scale mergers by unions in the transport industry. SATAWU organises workers in the transport sector as well as security and cleaning companies. The sectors include railways, harbours, parastatals, aviation, passenger transport (buses and taxis), freight (trucking), contract, cleaning and security. Through interviews with key personnel in the industry, the following relevant information was established:

- SATAWU estimates that there are roughly 350,000 taxis operating in the country;
- Most of the taxi industry is still informal – only 6,000 employers and 5,000 employees are registered for UIF payments;
- A Sectoral Determination on conditions of employment in the taxi industry was drawn up about five years ago but the industry has not complied;
- The Department of Labour commissioned research to be conducted on the lack of compliance with both the UIF and the Sectoral Determination in the industry but SATAWU has not seen the results of this research;
- The taxi recapitalisation programme has led to a large number of taxi owners now being registered with SARS, but this has not led to other aspects of formalisation (e.g. UIF contributions);
- Taxi drivers do not receive any social protection benefits and are faced with high levels of risk in their occupations. They feel that their conditions have not improved over time and that they are faced with high levels of uncertainty;
- Employment in the industry is not seen as long term and stable. Many workers job hop and work for different employers at different points in time. Many enter into the industry expecting it to be temporary; however, many find that 10 years later they are still in the same occupation;
- Taxi drivers have a willingness to save and many have created stokvels among themselves;

[27] A round trip costs R60–100 to a Labour Department Office and back to farm (interviewee).

- Some taxi drivers never meet their employer; they will be instructed to drop off the money at a particular location but will not have any face-to-face interaction;
- Taxi drivers' incomes range from about R400 to R700 per week (the average is usually R500 per week);
- Taxi drivers can be categorised into three groups according to the type of route they drive: rural, urban and long distance; and
- Drivers operating different routes are paid different amounts and those operating rural routes tend to be paid less than those driving urban routes.

5.2.8.2 Membership

Currently, the organisation has about 210,000 members. The amount of the union's subscription is:

- The equivalent of 1.5% of the employee's wage or salary; however
- If that amount is less than R30 per month, then R30;
- If that amount is more than R90 per month, then R90.

Generally, all members of SATAWU earn a regular income (i.e. a weekly or monthly wage or salary). The membership fee is therefore not a hindrance, and for most of the workers work contracts are in place.

5.2.8.3 Social protection benefits and challenges in extending provision for retirement

SATAWU members have access to some form of social protection. The SATAWU National Provident Fund was established on 1 February 1995 with the objective of providing retirement funding, death and disability benefits to its members and their dependants in return for the contributions paid by members and employers.

This Fund has been set up to provide members and dependants with the following benefits while a member is in the fund:

- Retirement benefits for the member;
- Death benefits for dependants should a member die;
- Funeral benefits should a member or family member die;
- Disability benefits should a member become disabled;
- Termination benefits should a member leave service; and
- Loans should a member wish to borrow money for housing purposes only (this money will be loaned from an approved home loan credit provider).

From June 2013 all consistent (with a good contribution record) members of SATAWU are being assisted with R10,000 in case of death, as a donation (i.e. a membership-based funeral assistance scheme). All consistent living members who retire as members of the organisation will be given a token of appreciation of R5,000 (i.e. a retirement incentive). Other services to members, which are to be channelled through Bashumi Investment Holdings, are in development.

SATAWU members have access to many social protection schemes in comparison to the members of the other organisations described in this section of the report. Most have access to the UIF, disability cover, death benefits, retirement provision, work accidents, funeral insurance and health insurance.

5.2.8.4 Potential uptake of retirement scheme

Most workers are permanently employed and therefore save toward their retirement through the compulsory contributions that are made. This retirement provision may therefore not be appealing for the majority of SATAWU members who are employees, although it may be relevant to those that are casual workers, temporarily employees and taxi drivers. However, the interviewees could not express a view as they are not mandated to do so.

5.2.8.5 Potential role SATAWU could play

Representatives of the organisation were not in a position to clarify this during the interviews without carrying out further consultations with their membership.

5.2.9 CWUSA

5.2.9.1 Organisation and its objectives

CWUSA describes itself as an organisation representing the needs of artists by providing a platform for expression and networking for a range of different artists including painter, presenters, musicians, and dancers. They also represent all other creative workers such as craftworkers, photographers, promoters, agents, and technical staff, etc. In essence, CWUSA provides assistance and advice for members regarding entertainment law and reviews contracts for members.

5.2.9.2 Membership

The organisation is membership based but, due to the sporadic nature of members' incomes, collecting membership fees is a challenge. Notwithstanding the collection challenges, however, CWUSA is currently running initiatives to create a database of members.

The industry faces a number of challenges, one of which is that artists are not defined as workers due to the absence of an employer–employee relationship. The relationship between the two parties is therefore informal and based on trust. The artist and company relationship is not regulated as it is based on contractual terms that are not automatically enforceable but are rather dependent on the ability of the aggrieved party to enforce them in the event of a breech. There are no formal guidelines as to how one can enter into the music or film business, meaning that artists, record labels, and other companies can enter into agreements with or without legal standing.

5.2.9.3 Social protection benefits and challenges in extending provision for retirement

Sponsored or charitable funerals have become synonymous with the creative industry. It is for this and other reasons that CWUSA has developed a Creative Industry Funeral and Investment Scheme (CIFIS), to be divided into three categories:

- Silver Status – this will be the entry level with limited benefits but sufficient to fulfil the core objective (funeral cover for the principal member);
- Gold Status – the second level of benefits, which includes funeral cover for the principal member and their immediate family members; and
- Platinum Status – the third level of benefits, which includes funeral cover for the principal member and their immediate family, plus life cover.

As the scheme funds grow and participation rates rise, it is believed that it could lead to the establishment of other necessary benefits like medical aid, financial investments, house subsidies, etc.

The first phase of the project was planned to start in October 2013 and will run for three years ending in October 2016. The first phase will focus on the accumulation of wealth, which is expected to rapidly generate interest on investments during 2013 to 2018. The total period for the pilot project will be five years and it will be subject to annual review. CWUSA entered into an agreement with Mvunonala Holdings in 2012, an asset management company, who will invest the proceeds made from the planned commercial activities.

5.2.9.4 Potential uptake of retirement scheme

Representatives of the fund communicated that a mandatory retirement system for workers in this industry would be beneficial.

5.2.9.5 Potential role CWUSA could play

CWUSA does not have the capacity to play a role collecting contributions and paying benefits. CWUSA relies on its relationships with appropriately qualified financial services providers to assist in this regard. The organisation could, however, provide education to members around social protection and financial services as this is aligned with the objectives of CIFIS.
AN

5.2.9.6 Organisation and its objectives

AN is an Africa-wide network of organisations, companies, festivals and individual artists working in the creative sector. The network aims to promote the African cultural sector and to have a positive influence on human rights, democracy and poverty alleviation through the arts. AN currently has a presence in 41 African countries and there are two regional secretariats (East and West Africa) to support the national chapters in their regions. Moreover, the Continental Secretariat is based in Cape Town.

5.2.9.7 Membership

AN's primary beneficiaries are artists. It has three levels of membership, which are all voluntary, and are characterised as: full membership, associate membership and honorary membership. The network has approximately 4,500 members, including both international and local contacts

AN has an office with paid staff in Cape Town. However, these do not represent artists since the AN is an advocacy group. According to the interviewees, the AN has little awareness of the pay structures operating in the creative industry.

5.2.9.8 Social protection benefits and challenges in extending provision for retirement

AN is a funded organisation and is accountable to its donors. AN therefore cannot provide retirement funding for its membership.

5.2.9.9 Potential uptake of retirement scheme

There will be resistance if becoming a member will have tax implications. Another challenge would be in ensuring member buy-in into the retirement scheme – to succeed, it must be run in a transparent manner.

Many artists work part time and therefore the mechanism for the retirement fund has to be coherent and comprehensively explained to such a membership group.
Potential role AN could play

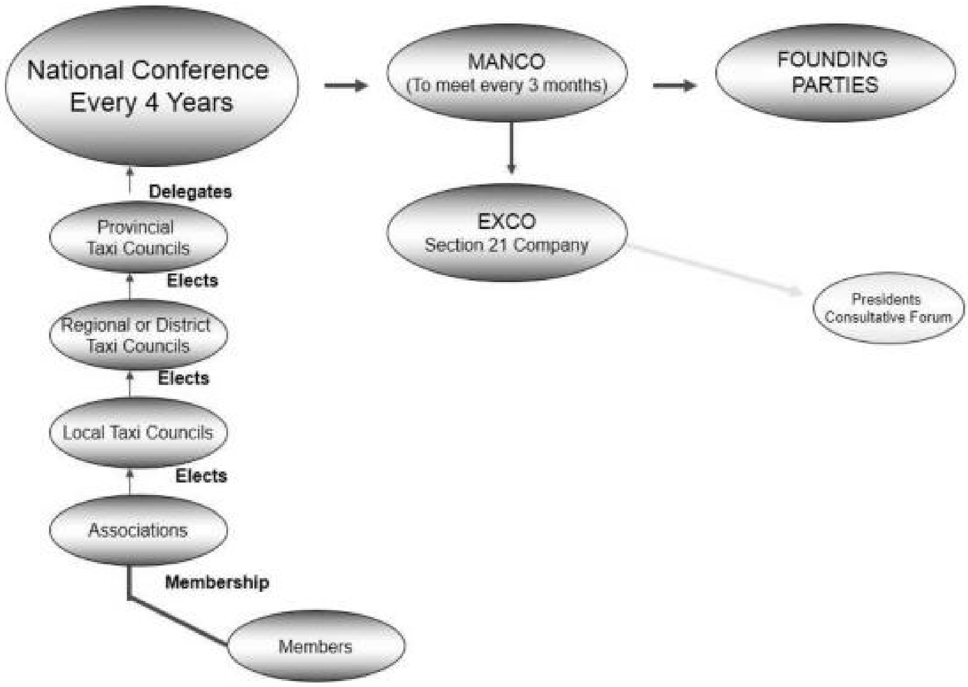
AN could lobby government to put together a succinct and well-motivated plan. This has to be a consultative process wherein government representatives explain the percentage of artists' income to be taxed. Members would also need to understand the necessity of additional taxation and how they derive benefits. It could also be beneficial to consult the Netherlands model on artistic workers, which is government funded and helps artists' careers through social services being subsidised.

5.2.10 SANTACO

5.2.10.1 Organisation and its objectives

The South Africa National Taxi Council (SANTACO) is an organisation that represents taxi owners all over South Africa. According to SANTACO, the industry owns 180 000 taxis, travelling 78 million kilometres and moving 15 million commuters a day. The council is an amalgamation of provincial councils which in turn represent regional, district and local councils and associations (see Figure 5.3)

Figure 5.3 Overview of SANTACO's membership structre



Source: http://www.santaco.co.za/organogram/

SANTACO's formation has brought and innovation and order to a previously unstructured industry. For instance, in July 2013 SANTACO launched a taxi fare index, to be used by associations to calculate taxi fares. Previously, taxi associations had no formal means of calculating what their fares should be. The index is based on a computer program that models the costs of taxi operations. The index will enable an association to enter data about its own routes — e.g. the length of the route, the number of passengers carried, and similar details — and get an accurate picture of what it should be charging. The index includes costs associated with the labour department's legal requirements, as well as with the employment of managers by associations to ensure operations are smooth and efficient. SANTACO is of the view that this is a step in the right direction to meet the needs of commuters and provide the necessary tools for taxi operators to manage their businesses in an efficient and professional manner.

5.2.10.2 Membership

Although specific numbers were not provided, the organisation claims to represent more than 60% of the estimated 110’000 or so taxi owners in the country. An annual membership fee of R250 is payable by members. Equal amounts are allocated as follows:

- Card issue;
- Members association;
- Regional office;
- Provincial office;
- National office.

5.2.10.3 Social protection benefits and challenges in extending provision for retirement

Most taxi drivers do not have any form of social protection, although they often have informal funeral cover.

5.2.10.4 Potential uptake of retirement scheme

The representatives acknowledged that the scheme sounded like a good idea but would need to be piloted with a controlled group/federal structures.

5.2.10.5 Potential role SANTACO could play

SANTACO has nine provincial structures (i.e. the provincial taxi councils). Each province is further broken down into district, regional and metropolitan taxi councils. These structures could all be used in informing/educating members about the retirement provision.

5.2.11 SAFPU

5.2.11.1 Organisation and its objectives

SAFPU is a trade union that represents football (soccer) players in South Africa. The aims and objectives of SAFPU include establishing economic and social justices for all members by means of regulating relationships between members and their employers, securing the settlement of disputes arising from employment issues and participating in any collective bargaining machinery. SAFPU also aims to protect the employment of members, to advance their employment prospects and, generally, to do things that will serve the interest of members socially and legally in their individual and collective capacity. On 29 March 2012 the Premier Soccer League (PSL) made its first collective bargaining agreement with SAFPU. The agreement gives SAFPU the opportunity to negotiate rights on behalf of the players. One of the key discussions involved in the agreement was the issue of basic wages paid to the soccer players who turn out in South Africa's domestic league.

5.2.11.2 Membership

SAFPU has a membership of close to 800 and is affiliated with the COSATU. The PSL has approximately 1,200 players. SAFPU therefore represents roughly 67% of all professional football players.

Full membership extends to all players and former players associated with professional football clubs in the PSL and amateur football clubs affiliated to South African Football Association (SAFA). Salaried full members and associate members pay a monthly subscription fee of 1% of their basic salary/wage subject to a maximum of R1,000 a month. Although members are eager to join and do not see the membership fee as a hindrance, receiving the funds from the clubs is a hindrance as they are not disciplined or consistent in regard to collecting fees and paying them over to SAFPU.

At National First Division level, players' salaries can range from R1,000 to R10,000+, while at PSL level, players' salaries can range from R1,000 to R100,000+. The typical professional player trains daily for a maximum of 3–4 hours. Their working conditions are therefore generally not problematic. The areas of concern are mainly contractual terms and the lack of available of social protection, e.g. medical aid and retirement planning.

Members generally have some form of social protection apart from the UIF. Most have cover against disability, death and work accidents.

5.2.11.3 Potential uptake of retirement scheme

The industry is unique in that players' employment term is typically 15 years (at best), making their 'retirement age' 35 years (at best). Players approaching retirement grapple with the issue of how to survive between their 'sport retirement age' and 'traditional retirement age'. It is this gap that is a major challenge that SAFPU would like to see addressed.

To this end, SAFPU has engaged stakeholders to confirm:

- that retirement age can be adjusted in the case of a unique industry such as seasonal workers in the sports fraternity; and
- that government has appetite to explore alternative ways to ease the tax payable by seasonal workers and use that 'benefit' to facilitate a solution that would provide retired football players with the financial and non-financial support to enable them to find alternative ways of generating income and sustaining their livelihood until they reach 'traditional retirement age', during which time they would be able to participate in the proposed retirement provisions for informal workers.

5.2.11.4 Potential role SAFPU could play

SAFPU would be able to assist with educating its members about the product, providing appropriate training material and access to qualified facilitators to assist in this.

5.2.12 Absa

5.2.12.1 Organisation and its objectives

Absa Consultants and Actuaries offers the following individualised employee benefits schemes:

- Home employees provident fund;

- Agricultural sector provident fund; and
- Small business provident fund.

Because the risk profiling and actuarial calculations are based on wages paid and each of the three sectors is unique with respect to worker's earnings levels, the Absa developed multiple sector specific funds. By registering employees as members of a fund, an employer's social responsibilities toward them at retirement, in the case of disablement or unforeseen death and the resulting funeral costs and financial assistance to dependants afterwards, decrease.

Generally, the Absa funds have the following features:

- Fixed monthly contribution (although top ups can be done);
- All contribution payments are done via debit order;
- Benefit statement is sent to the employer;
- Member is entitled to fund value on resignation or retirement;
- Premium increases are aligned with minimum wage adjustments

The average value of accumulated benefits is between R2,000 and R3,000 and the estimated accumulated annual savings hover around R1,000. The reasons why these figures are relatively low is that majority of clients have not been contributing towards a policy for an extending period of time and the employees tend to withdraw the fund value when changing jobs.

5.2.12.2 Membership

At the time that the domestic workers' book was taken over from Fedsure/Investec in 2003, there were 25,000 members (including inactive, non-contributing and unclaimed). There are currently 20,000 members on the book.

5.2.12.3 Social protection benefits and challenges in extending provision for retirement

As a service provider and not a representative of workers in different sectors, Absa could not comment on the current social protection landscape and its suitability for informal workers. They spotted the gap with respect to retirement savings hence their initiative to launch the different sector funds.

5.2.12.4 Potential role Absa could play

Employers' interest in the policy tends to be more for the funeral cover than the retirement cover, as this indirectly enables the employer to assist with a contribution without being out of pocket. Offering a pure retirement solution may therefore not attract employers and would therefore need to be positioned to be attractive to employees. Absa's relationship with AGRI SA is such that they assist with marketing the product to members and on-boarding new clients. Although this has been helpful, it has not been highly effective. A more effective approach would be for an intermediary/broker to have a one-on-one discussion with a potential client.

Absa advised that there are some challenges that government would need to be weary of in establishing a fund for informal sector workers. Some of these challenges include the difficulty in finding a competent administrator with the capacity to efficiently manage over a million plus members (provided take up is high). Another challenge is that premium collection, especially when don directly from the workers (and not through the employer) will not be easy.

5.2.13 GDS

5.2.13.1 Objectives

The GDS is tasked with transforming the delivery of sport and recreation by ensuring equitable access, development and excellence at all levels of participation and to harness the socio-economic contributions that can create a better life for all South Africans. The National Sports and Recreation Plan specifically focuses on the following strategic objectives to assist with broadening the base of sport and recreation in South Africa:

- To improve the health and wellbeing of the nation by providing mass participation opportunities through active recreation;
- To maximise access to sport, recreation and physical education in every school in South Africa; and
- To promote participation in sport and recreation by initiating and implementing targeted campaigns.

The core business of the department is the promotion and development of sport and recreation, the coordination of the relationships between national federations and other agencies, provision for interventions to correct imbalances in sport and recreation, and the promotion of equitable access and proper governance in sport and recreation. It also works to create an enabling environment that contributes toward transformation, rural development, job creation, a healthy lifestyle, peace, and economic growth. The department supports those responsible for the delivery of sport with available resources. The department also oversees the implementation of projects and evaluates results to ensure that it delivers value for public funding as well as to feedback into policy development.

The department does not represent any workers. However, the department focuses on empowering educators in code-specific coaching, technical officiating, team management and sports administration through the federations and in line with the South Africa Coaching Framework. It also focuses on integrating 16 sporting codes and indigenous games into the school sport system over the medium term with the alignment of school code structures and federation structures.

5.2.14 Key observations/conclusions from KIIs

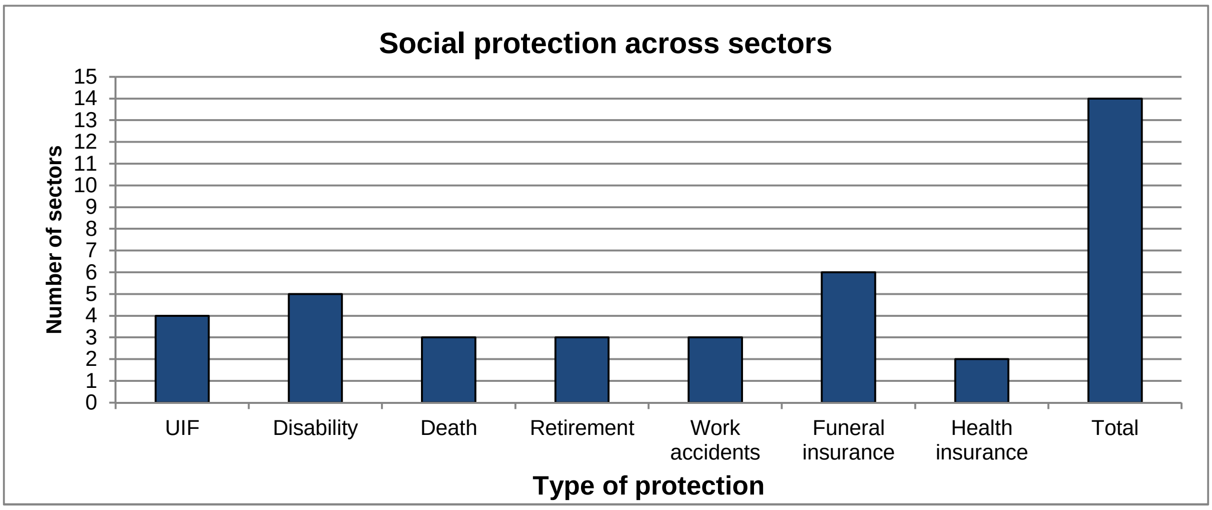
Income levels: There is a huge variability in earnings across the industries. Some workers receive regular incomes (e.g. those in the transport sector) while others (such as artists) experience more erratic incomes. On the one hand, this shows that there is definitely a need for a pension system among informal workers. On the other, it shows that designing an appropriate contributory system will be challenging as earnings are markedly different.

Potential uptake of scheme: Representatives of all of the organisations we interviewed not only expressed interest on behalf of their members, but also appreciated that it was a necessity. It would appear that there is a huge market for the scheme. However, actual uptake will depend on the scheme’s flexibility in presenting retirement solutions for informal workers. Uptake will potentially be influenced by the risk benefits included, as nearly all organisations interviewed have some sort of risk benefit scheme for their members.

Flexibility of the scheme: The scheme will have to be flexible enough to meet the needs of the different sectors, while remaining simple and straightforward enough for beneficiaries to trust it.

Assistance from organisations: From the responses, it appears that many organisations would like to help their members, especially in terms of advocacy and communication. Some organisations will find it easier than others will, so sector-specific approaches may be needed to ensure that, across all sectors, adequate information about the scheme will reach the target audiences.

Figure 5.4 Social protection among informal workers in South Africa



Levels of social protection in general: There are low levels of social protection in general across the represented sectors. As Figure 5.4 shows, of the 14 entities with which KIIs were conducted, less than half had access to social protection for their members. Nearly half had some form of funeral assistance for their members or indicated that workers in the industry/sector represented had funeral protection. In only three organisations was access to retirement provision reported.

5.3 Focus group discussions

Using the state proposal for a mandatory contributory provision for retirement outlined in Section 5.1 above as a baseline, FGDs were conducted to explore some of the assumptions and establish some baseline parameters of what a similar fund for informal workers would have to look like.

In total, four focus groups were held, each with between five and eight participants. Each group differed in terms of the characteristics of the key participants involved, as well as the location and type of work that the participants did. A key consideration in selecting groupings was that retirement provision for informal workers with the lowest incomes in South Africa is currently catered for through the current State Old Age Pension (SOAP). Hence, the proposed contributory system will therefore be most relevant to informal workers with somewhat higher levels of income. As a result, the sample of informal workers was such that the participants earned somewhat higher incomes than those can be called the 'poorest survivalists'.

Specific details of the FGDs' methodology, participant selection and survey tools are appended to this report as Annex A. In this section of the report, the main findings of the FGDs are discussed.

Group 1 consisted of four male and one female leaders of five of the 12 markets in Warwick Junction. They belong to various trade organisations, member-based organisations and committees relating to informal workers. In addition to representative positions in these organisations, all participants are informal workers themselves. The group had the highest average age amongst the various focus groups (50 years), with ages ranging from 33 to 62 years of age. As representatives of groupings of informal workers they could contribute towards an understanding of their own as well as their members' interests.

Members of Group 1 are predominantly the sole earners in their households. This group also has fewer recipients of grant income relative to groups 3 and 4. The participants in Group 1 who did save have access to formal savings institutions and used bank accounts as their primary savings mechanism. With regards to assets, Group 1 ranked the second highest in terms of relative wealth using an 'asset proxy'. In sum, Group 1 consists of participants who are relatively well off (particularly compared to groups 3 and 4) and have access to formal savings mechanisms

Group 2 was an all-male group with an average age of 45 (ranging from 33 to 60 years). All are traders from the Warwick Junction area and members of the organisation 'Traders Against Crime'. On average, they have the highest aggregate level of assets in the asset register and seemed to be slightly better-off than the other groups.

Group 2 has marginally more participants who come from households who have more than one income earner than in Group 1. With regards to grant income, we observed that Group 2 had the lowest number of participants earning grant income relative to the other groups. In terms of savings, we found that most Group 2 participants did save and that all but one saved through formal bank accounts and therefore had access to formal savings mechanisms or institutions. With regards to relative wealth measured using an 'asset proxy', we found that Group 2 was the most affluent group relative to the other three participating groups.

Group 3 was a group of women traders from the Bester Market, a peri-urban area with differing characteristics to those of the city centre. The market has recently suffered a loss of business due to the construction of a shopping mall in the area. Most of the women are in their 30s apart from one younger (28) participant and one older participant (46). They predominantly sell food, drinks and basic household goods from containers in the market.

We found Group 3 to have the highest number of participants who came from households with more than one income earner. This may have been due to the fact that the participants in this group were all female, although there is no clear evidence to support this linkage. With regards to grant income, we found that seven of the eight participants in this group receive grant income. This proportion is significantly higher than for groups 1 and 2. With regards to savings, we found that far fewer participants saved with formal financial institutions relative to groups 1 and 2, and that more participants saved using *stokvels*. This suggests that participants in Group 3 have limited access to formal savings or financial institutions relative to groups 1 and 2. With regards to an 'asset proxy', we found that Group 3 ranked third of all the groups. Overall, Group 3 is a relatively less affluent group (relative to groups 1 and 2) but is more affluent than Group 4.

Group 4 was an all-female group of *impepho* and lime sellers (four *impepho* sellers and four lime sellers)[28] operating in the *impepho* and lime market in the Warwick Junction area. The group has the youngest average age (33 years), the lowest level of assets and the highest level of income insecurity. The women come from rural areas and spend two weeks every month gathering *impepho* or mining lime in the rural areas; they then travel to Durban to spend two weeks selling the *impepho* and lime in the market. During their stay in Durban, they sleep in the market which is situated below a highway near Warwick Junction.

Group 4 had a low number of participants who came from households with more than one income. This group also had the highest number of participants receiving grant income relative to the other groups (all eight participants in Group 4 received grant income). With regards to savings, most of the participants who indicated that they saved used *stokvels* to save rather than formal financial institutions. This may be an indication that participants in Group 4 have little access to formal financial institutions. With regards to the

[28] *Impepho* is a traditional incense used to communicate with ancestors or to ward off evil spirits. *Umcako* (white lime) and *ibomvu* (red lime) are both mined in iNdwedwe, KwaZulu-Natal and are used by trainee and qualified *izangomas* by being applied to the skin. For more information, see www.marketsofwarwick.co.za/mpepho-and-lime-market.

‘asset proxy’, we found that participants in Group 4 ranked lowest relative to groups 1, 2 and 3. Overall, it appears that Group 4 is the least affluent group and that participants in this group have limited access to formal financial institutions.

5.3.1 Current plans for retirement provision

In order to get a sense of the viability of a retirement savings mechanism for informal workers, it is important to understand their current thinking around retirement provision and what mechanisms they are currently using to provide for themselves at retirement (if any).

To address these issues, participants were presented with a set of nine cards. Each of the cards showed a potential means for supporting oneself when in old age. The participants were then asked to select the cards that represented their *current* retirement provision strategies and rank them in order of importance. The options on the cards were:

- Carry on working;
- Rent income;
- Widow/widower’s work pension;
- My husband/wife;
- My grandchildren;
- The SOAP;
- My children;
- The child support grant;
- My own savings.

Participants were also given the option of adding a means of support/retirement mechanism to blank cards that were supplied to the group. All cards were placed face up on a table and each focus group participant had a turn at ranking their own personal plans for support in old age. Participants were not obliged to use all the cards and they were instructed to choose only strategies that they actually planned to use.

5.3.2 Common strategies in all groups

In spite of the fact that the participants from the groups had different characteristics, some mechanisms were common across the groups. The three most common responses were ‘own savings’, ‘carry on working’ and the ‘SOAP’. Each is discussed in turn below.

5.3.2.1 Own savings

This was one of the most frequently selected and highest-ranked cards among and across all four groups. ‘Own savings’ came up in the top three options for all but three of the participants. In Group 2, all but one participant (who added ‘funeral plan’ to the options and chose this as her only plan) chose ‘own savings’ as their first option. The individual participant information sheets (IPISs) provided useful information on the type of savings used by each participant. Eleven participants used only a bank account for savings while eight participants used only *stokvels*. Five participants used a combination of both. Bank accounts were most common in groups 1, 2 and 3, while those in Group 4 (the younger women from rural areas) tended to use only a *stokvel* as a means of saving.

While ‘own savings’ therefore ranked highly as a retirement provision mechanism, very few of the participants contributed to dedicated retirement-focused financial schemes such as pensions or provident funds. The predominant vehicles for savings were traditionally more short-term mechanisms such as bank accounts and *stokvels*.

5.3.2.2 Carry on working

Most participants selected ‘carry on working’ as part of their plans for old age. Only three participants in total did not choose this as an option. Of those who did choose it, it was frequently chosen as the first option. Group 4 in particular chose ‘carry on working’ as their primary means for support in old age. This suggests that informal workers currently have limited means to provide for themselves in retirement and many are likely to have to continue to work upon reaching retirement age.

5.3.2.3 SOAP

Many participants chose the SOAP as part of their current retirement plans. Interestingly, while it was a commonly chosen option, it was never chosen as the top ranked option. It was chosen as the second option for seven participants, the third option for four participants and the rest ranked it fourth or lower. The SOAP appears to be seen more as a supplement to other plans rather than a primary means of support for informal workers.

5.3.2.4 Common strategy for all-female groups: Children

It should be noted that the all-female groups differed slightly from the others in that one mechanism was chosen more frequently by these groups. Support from children was a more commonly chosen and higher-ranked option for female participants than for male participants. This was chosen frequently in groups 3 and 4 (i.e. the all-female groups). In Group 3, ‘my children’ was chosen as the second option (after ‘savings’) by three participants. Eight participants (all from groups 3 and 4) chose ‘my children’ as their third option. In the male groups, this option was seldom chosen, and when chosen ranked only after four or five other means of support.

5.3.2.5 Least common strategies

‘My grandchildren’ and the ‘child support grant’ were chosen occasionally by participants but were never highly ranked. Rent income was only chosen by one participant but ranked fairly low in their list of strategies. Only five of the participants chose ‘my husband/wife’ and one participant chose ‘widow’s work pension’. In Group 4, few participants chose the ‘my husband/wife’ card; when asked why, a participant answered ‘*You shouldn’t even have added that card. People do not get married anymore*’ (Group 3, Participant 7).

5.3.3 Retirement reform – responses to the new pensions system

5.3.3.1 Presenting the new pensions system

In presenting the new retirement system to the focus groups, use was made of two posters outlining the reforms (see Annex A). The first explained SOAP, the current state-provided pension mechanism available to informal workers. In the second poster, the essence of a potential new **contributory** retirement savings mechanism was then presented to participants along with the risk benefits that could potentially be linked to the new retirement benefit (i.e. a **disability** and a **death** benefit).

5.3.3.2 Acceptability of the pensions system

There was consensus in all focus groups on the **desirability and perceived usefulness of the proposed retirement system**. All participants displayed an interest in the contributory savings system along with a willingness to participate in it. Most also said that they would have the ability to pay into the system (contingent upon the required contributions not being too high). Only one out of the 26 expressed concern over not being able to afford to pay into the system. However, she came from Group 4 (i.e. the group with the least secure income situation) and in fact her statement was met with much resistance from the rest of the group.

Overall, participants were clearly receptive to the idea and it appears that this type of retirement provision mechanism would address an existing gap in the market of savings mechanisms for informal workers. However, there was a marked degree of **mistrust of both formal and informal financial institutions**. Participants complained that formal financial institutions make it difficult for informal workers to open savings accounts and that they are subsequently forced to save their money through informal mechanisms that are often unreliable. A participant stated that workers were '*tired of having their money stolen by amaIndia*[29]' (Group 1, Participant 1). Some participants, particularly in Group 4, cited high bank charges as a disincentive to saving their monies with formal financial institutions. One participant also made an interesting comment on the disincentive effect the means-testing component of the SOAP has in terms of formal savings, lending support to the desirability of universalising the SOAP. The participant stated that the government had traced how much money her brother had in his bank account and when he went to collect the SOAP he was turned away because he had 'too much money' (Group 4, Participant 4). Although we are unable to verify this interpretation, it is worth noting that a linkage between SOAP and formal savings is perceived to exist and that this connection may make people less open to formal saving.

The points raised showed the need for more reliable savings mechanisms for informal workers. However, as was clarified in the focus groups, the proposed mechanism is aimed primarily at retirement provision coupled with the proposed risk benefits, and is not designed to be a general savings vehicle for informal workers. It may be necessary to address the obstacles to saving faced by informal workers as part of a broader strategy aimed at improving the financial security and subsequent welfare of informal workers.

Some of the participants expressed concerns regarding who would manage the scheme. They wanted to know whether private companies or the government would run the scheme, as both were seen to raise a different set of problems. Participants wanted to have the security and cost-effectiveness of government (i.e. private company charges are perceived to be too high and participants have had previous schemes closed due to periods of non-payment) but with the efficiency of the private sector (i.e. the government is perceived as being too slow to respond to claims). Participants also clearly highlighted their mistrust of municipal authorities (local government) and their preference for national government to manage the mechanism.

5.3.4 Nature of contributions payments

5.3.4.1 Payments as a percentage of monthly income

The idea of **paying a monthly contribution based on a percentage of monthly income was viewed with scepticism** by informal workers as it would rely on self-reporting. This was seen as being problematic for two main reasons:

- The inconsistency of their incomes makes it difficult to determine what their 'monthly' income actually is; and
- Fear of tax implications would mean that informal workers would be reluctant to reveal their income levels.

29 We cannot say with certainty which 'amaIndia' the participant was referring to. However, from the conversation we gather that they may be referring to a particular individual(s) who purported to be providing a savings service.

Participants made comments suggesting that it would not be feasible: *'Workers make different amounts from month to month, so* [taking a percentage of monthly income] *won't work because it is too difficult to take a proportion of our income as traders'* (Group 2, Participant 4). They also made comments showing that the system would also be undesirable and act as a disincentive for participation: *'I wouldn't completely disclose my actual income because I don't want that to go to SARS* ().'

Participants suggested that they would prefer to pay in variable amounts, adjusting according to their circumstances that particular month (i.e. more in good months and less in bad months). However, it is important to them that this is not explicitly stated as a set percentage of their income.

5.3.4.2 Preservation in the event of non-payment

Due to the variable nature of their incomes, many participants voiced concerns over what would happen to their previous contributions in the event that they defaulted on their monthly contributions. They fully understood the need for responsibility with regard to regular payments, but did not want a scheme that was punitive.

Almost all the participants agreed that many informal workers would be able to make a **mandatory monthly contribution to a contributory retirement provision mechanism on condition that the monthly contribution fees are relatively low**. When asked what a relatively low fee would be, a participant answered '*I pay R60 for my masingcwabisane*[30]' (Group 1, Participant 2), while another participant said '*I think R100 is okay for all the benefits'* (Group1, Participant 4). Some participants suggested that a minimum monthly contribution rate be set at a fairly low amount and that participants be given the option to contribute more than the minimum if their financial situations allowed this. One of the participants was of the opinion that '*very few people would not be able to contribute due to a lack of resources'* ().

5.3.4.3 Flexibility in price and period

Many participants suggested that they would be interested in participating in the scheme on condition that it took into account the fact that they had fluctuating incomes. They suggested that the scheme be flexible in two possible ways:

Flexibility in contribution amounts: participants expressed a desire for flexibility in terms of contributions to be made. They believed that **informal workers should be allowed to contribute amounts that they can afford as opposed to a fixed monthly contribution** that may be above the level they could afford in bad months. They suggested that this would allow informal workers to still meet their contribution obligations by making smaller payments in months in which their incomes are very low. However, most participants seemed to agree that a low minimum monthly premium would be affordable and would leave the option to pay in more during good financial months.

Flexibility in contribution periods: they also expressed a need for the mechanism to be flexible in terms of *when* informal workers are able to make their monthly contributions. There were two suggestions in this regard. The first was that if informal workers are unable to make their monthly contributions in a particular month that they be allowed a **grace period** in which they can make the payment that they missed. The second suggestion was that informal workers be given the opportunity to **pay their monthly premiums up front**. For instance, if a worker knows that in particular months they are likely to have lower incomes than other months, then those workers should be allowed to make payments up front, i.e. in the months prior to those in which they anticipate their incomes being lower.

30 A *masingcwabisane* is an informal burial society in which members contribute a set sum of money at a set time.

5.3.4.4 Voluntary contributions

Some participants suggested that participation in the system should be mandatory and that informal workers should work toward making this contribution. One participant said: '*it will be like my permit; it's a lot of money but I make sure that I have paid because I don't have a choice*' (Group 4, Participant 6). However, this suggestion met a fair amount of opposition in the focus groups. **Most participants seemed to prefer a system based on voluntary participation**: '*we should not be forced* [to be part of the scheme] *but government should work with the structures* [of informal workers] *on the streets to convince and educate street workers on the importance of the new pension*' (Group 1, Participant 1). Educating and encouraging workers to join voluntarily was considered important for attracting people to the system. The absence of this buy-in would render the mechanism ineffective in terms of capturing informal workers. In reality, making participation in a contributory retirement savings mechanism for informal workers mandatory is not practical.

5.3.4.5 Government contributions

Many participants asked if the 'government' would match or subsidise their contributions to the scheme. Exact methods and levels of subsidising were not discussed as it was explained to participants that the details of the design of the system have not yet been finalised.

5.3.4.6 Methods of contribution

Participants were also keen to learn whether making contributions to the new mechanism will result in their having to open separate bank accounts or whether the mechanism would allow them to continue to use their current savings mechanisms: '*Is it a different savings account or do I continue saving the way I've always saved*?' (Group 3, Participant 2).

As previously mentioned, many informal workers currently lack access to formal financial instruments. This is something that would have to be considered in the design of the method of contribution if informal workers are to be effectively included in the system. The use of bank accounts as a method of payment into the system, in the absence of interventions to address the financial access constraints faced by informal workers, could act as a significant barrier to participation in the scheme.

5.3.5 Using existing state contributions

In regard to sources of funds for contributions, one participant suggested that a proportion of the funds they pay for permits should be used to cover the contributions for the proposed retirement savings mechanism. One participant from the first focus group said: '*We pay the government but we don't see where this money is going. We request that the money we pay to the government for permits be used for insurance and retirement*' (Group 1, Participant 1).

A particularly interesting finding came from discussions in both of the all-female groups. Some of the women in the groups are receiving the child support grant and suggested that if they were to have a particularly bad month of earnings and felt unable to contribute toward the scheme from their earnings, they would prefer to have the grant money paid into the system to cover the contribution, with the difference then paid out to them. One participant said '*If I fail in business can the government not deduct from the child support grant into my pension scheme?*' (Group 3, Participant 4), while another stated '*I work for someone else. If I get fired then I think they could deduct my contribution from my child support grant*' (Group 3, Participant 7). The comments from the focus groups suggest that informal workers are not myopic in relation to their financial situations and, in this particular instance, would actively choose to sacrifice present consumption for future savings.

5.3.6 Risk and other benefits – proposed and suggested

In addition to the benefits proposed in the scheme as outlined in the posters in Annex A, the focus group participants suggested a wide array of benefits that they would like the proposed mechanism to provide in addition to retirement benefits. These included education funds, unemployment benefits and the like. This enthusiasm for added benefits was not unexpected due to the lack of access that informal workers have to crucial benefits and services. Notwithstanding this, the team tried to limit the discussion to retirement provision and used the posters to guide the conversations back to the core issue of retirement provision. That said, the challenges faced by informal workers regarding financial inclusion and access to services such as education and health care need to be understood, as they will have an impact on the design and implementation of the proposed retirement provision mechanism.

The six main proposed and suggested benefits are discussed in turn below.

5.3.6.1 Death benefits

The question of death came up often and early in all of the FGDs, highlighting the importance of the death benefit in the proposed reforms. One participant felt that it was unlikely that she would reach retirement age and that she therefore had little need to save for retirement. However, a more common concern was what would happen to contributions if the individual died before reaching retirement age. Participants were concerned about having to pay into a system over the course of their working lives and subsequently losing those contributions in the event that something happened to them. The death benefits outlined in the posters were met with much enthusiasm, as participants felt that this would provide support to their families when they died.

5.3.6.2 Medical benefits

Many participants highlighted the importance of a medical benefit for the retirement savings mechanism. The participants stressed that medical expenses are prohibitively high and that informal workers struggle to cover the costs of high-quality medical expenses. The situation is further exacerbated because the time informal workers spend away from their jobs because of injury or illness often means they are losing potential income. As such, there is a need for fast and effective treatment that tends to be expensive. Also, participants pointed out that informal workers are often faced with health concerns due to the nature of the work that they do (poor health and safety standards), making access to good quality health care crucial. Concerns were also raised in relation to aged informal workers having poor access to health care simply because they cannot afford it. Participants were therefore keen to ensure that access to good quality health care was a part of a contributory retirement provision mechanism.[31]

5.3.6.3 Funeral benefits

Informal workers in all groups – and especially at Bester and in the *impepho* and lime markets – highlighted the importance of a funeral benefit for participants in the scheme. They also stated that they would need a funeral benefit for their immediate family because the funerals of relatives were large expense items for them. Participants envisage that contributions to a retirement savings mechanism with this type of funeral benefit would allow them to stop contributing to *masingcwabisane* schemes, which they perceive as unreliable. One participant said: '*we would also like a funeral benefit. The masingcwabisane is not reliable because people don't get the correct payment when they need it and the money paid out is too little*' (Group 1, Participant 4).

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31 The OPM team is aware of the parallel plans to introduce National Health Insurance, which may assist in addressing the issue of accessing high quality and affordable health care for all South Africans, including informal workers.

5.3.6.4 Education funds

Many participants cited the financial burden of educating their children as one of their biggest concerns. They felt that an education fund could be established from the pool of resources, which would then allow informal workers to educate their children. Of particular concern was the higher cost of tertiary education fees.

5.3.6.5 Collateral and loan facilities

Some participants suggested that the fund should allow individuals to make withdrawals in the form of loans that informal workers could use to invest in their businesses. The rationale is that the fund could use contributions that workers have already made to the fund as collateral for loans and thus create an avenue for informal workers to access credit they would ordinarily struggle to get. While this is a problem that could be better addressed through improved credit markets in the country, it is possible that the retirement system could have an indirect beneficial effect in that a history of continuity in contributions may act as a substitute for a credit history for informal workers, consequently having an indirect positive effect on credit access.

5.3.6.6 Unemployment benefit

Many of the FGD participants cited unemployment and/or an inability to trade as one of their biggest concerns. Some asked if they would receive a benefit from the mechanism in the event that their businesses failed before they reached retirement age. Although participants were informed that the mechanism was only geared at retirement provision, this sentiment showed the importance of and need for some sort of unemployment benefit that informal workers can access.

5.3.7 Payment of benefits

5.3.7.1 Death

Participants were clear on who would receive the retirement and disability benefits, but many participants were concerned about who would receive the death benefit in the event of their passing: '*What if I have a funeral plan and my child takes my funeral plan money and drinks it all?*' (Group 3, Participant 4). The groups displayed a distinct preference for having the death benefit paid out as a monthly sum of money rather than as an initial lump sum: '*If I die, the SOAP gets cut. If I die, will my children get the benefit monthly? It would be better if they get it monthly because it is like I am still there providing monthly*' (Group 4, participants 1 and 6).

5.3.8 Preservation and early retirement

As mentioned earlier, many informal workers raised concerns over non-payment of contributions due to their variable incomes. Many asked what would happen to their paid contributions in the event that they could no longer make contributions to the mechanism. There was concern over whether participants would lose these contributions (as has happened to some participants using private schemes) or whether there would be either a smaller pension that they earn on retirement or a payment of funds that they would receive once they fall out of the mechanism.

The concern over non-payment of contributions came across strongly. While Section 5.3.4.2 discussed the treatment of payment defaults over shorter periods, this concern is about the treatment of long-term default. The fact that participants so often raised the issue of non-payment clearly shows their understanding of the volatility of their financial situations, and it is crucial that the design of the proposed retirement provision mechanism takes this volatility into account. In sum, any mechanism designed to include informal workers will invariably have to accommodate income volatility or it will not work.

5.3.9 Potential shortcomings of the new system

5.3.9.1 Mistrust of municipal authorities

There was consensus within and across focus groups that tension between municipal authorities and informal workers had rendered relations between the two groups strained at best. Participants suggested that if national government plans to implement this scheme and garner the support of informal workers, it is essential that these tensions be addressed: *'National government should have offices all over the country to oversee this problem*' (Group 1, Participant 4). Some participants suggested that national government should implement the programme directly and exclude municipal authorities from its implementation, while others suggested that until municipal authorities stop 'harassing' informal workers there will be very little buy-in on the part of informal workers. In the words of one participant: '*The approach to implementation could be a problem. If local municipalities implement this scheme there will be a problem because we have conflicts with local governments'* (Group 1, Participant 4).

5.3.9.2 Mistrust of national government

There was also a fair amount of mistrust of national government's consultation process, particularly among participants in Group 1. Based on their past experience, the main complaint was of national government consulting informal workers (or with the leaders of informal workers) but never giving feedback on the results of their consultations. Participants also spoke of consultations only being held with younger informal workers' leaders as opposed to a combination of younger and older leaders (who are more experienced and can provide better context on the issues pertinent to informal workers). One participant stated: *'The main issue is: how do we know what happens with our inputs? We want transparency and communication back from our inputs*. *National government must be clear because we see problems at the national level as well. There must be proper consultation with the proper people, older people'* (Group 1, Participant 3).

5.3.9.3 Mistrust of financial institutions and savings vehicles

Participants cautioned about the mistrust that informal workers may have if the proposed 'new pension' was perceived to be a private or informal sector retirement savings scheme. One participant stated that, '*When government takes this it must send a team out and work with us to implement it because it could create scope for opportunists and criminals to steal from people'* (Group 1, Participant 4). Participants suggested that the new mechanism be clearly identifiable and easily recognisable as a government initiative: *'The new pension must have an account number that everybody knows and can make contributions to. It must also have a clear logo that everybody knows so that people are not cheated*' (Group 1, Participant 1).

5.3.9.4 Equity in contributions and benefits

Some participants were concerned about the equity of the proposed scheme, particularly if participants will be permitted to make variable contributions based on the amounts they can afford. Participants wanted to know if they would receive the same benefits at retirement regardless of the differences in contribution and preferred that those making higher contributions should receive greater benefits.

5.3.9.5 Conditions faced by informal workers

There was consensus both within and across the groups that, in order for the scheme to work as envisaged, it should be part of a broader effort to improve the working conditions of informal workers. Informal workers operate in an inherently risky environment and financial volatility is one of their biggest concerns. In that vein, participants referred to their inability to access credit to start or expand their businesses.

It was evident that they felt that municipal authorities viewed them as a problem, rather than as entrepreneurs who could potentially have a positive impact on economic growth. Their incorporation in more entrepreneurial development programmes is crucial.

5.3.10 Conclusions and lessons from FGDs

The FGDs provided a wealth of information, both on how informal workers currently plan for and think about retirement and on their thoughts and ideas around the proposed contributory pension system. Some of the key lessons learnt through the discussions include:

***Willingness and ability to pay*:** There was a high level of willingness to participate in a contributory pension system. More importantly, participants also felt that most informal workers would have the ability to do so as long as the expected contributions were not too high.

***Risk benefits*:** The death and disability benefits were met with great enthusiasm. The death benefit in particular addresses a key concern that came up early in all FGDs, i.e. what would happen to the contributions and whether their dependents would benefit from these contributions in the event of their death. Participants seemed to display a preference for monthly payments instead of an initial lump sum in the event of death.[32]

***Minimum monthly contributions and options for top-ups*:** Many suggested that if one chooses to participate in the system, one should pay a mandatory minimum but have the option to contribute more. There was great resistance to the idea of basing payment on incomes earned. However, their responses seemed to suggest that the way in which they would pay in would effectively constitute the same thing (i.e. in months of higher income, they would pay in a greater amount). Nevertheless, it is important that the contributions never explicitly be stated as a set percentage of income, as this is likely to be a disincentive for participation due to taxation fears.

***Flexibility in contributions*:** Due to the fluctuations they experience in their income, participants underscored the need for flexibility in the system. Most importantly, they felt they needed flexibility in terms of the contribution amount they would be expected to pay each month. Some participants suggested that there should also be flexibility in *when* they could pay into the system. One participant felt that they should either be able to pay a larger sum up front in good months to cover for months they knew would be bad or the ability to repay in future to make up for periods of non-payment.

***Greater contributions to translate into greater benefits (transparency in contributions and benefits)*:** Participants felt that higher levels of contributions needed to translate into higher levels of benefits in order to encourage workers to pay more into the system and to make the system fair. It is important that there is transparency and readily available information as to what level of benefits the contributions translate into.

32 However, it must be noted that, due to the lack of specific information on the functioning of the system (as was raised in Section 2.4), we were unable to explore in great detail how the risk benefits would work. What we did manage to do was use examples of existing benefits (the social assistance disability benefit for instance) to explain the general concept of the proposed risk benefits: death and disability. We also stressed that, unlike the social assistance benefits, these risk benefits would be linked to a contributory retirement provision mechanism.

***Information and education to encourage participation instead of mandatory participation*:** It was felt that informal workers should be encouraged to participate in the system through the provision of education and information on the system and its benefits rather than being forced into the system. Appropriate levels of information and accessibility to the system would be likely to yield high levels of participation, as the system addresses the current savings and insurance gap faced by informal workers.

***Preservation of savings is important in the event of non-payment*:** Participants expressed a need for preservation of their accumulated savings in the event of non-payment, as this has been a disincentive for informal workers to enter into formal insurance schemes in the private sector in the past. They expressed a need for grace periods during months in which they were unable to make contributions.

***Suggested additional benefits included medical cover, education withdrawals, loan facilities, funeral benefits and unemployment benefit*:** Participants expressed a need for additional benefits to be included in the system. Some of these may be better addressed outside of the retirement system (e.g. access to credit, medical cover), but others could potentially become part of the retirement system design (e.g. unemployment benefits and withdrawals allowed for education expenditure).

***Administration through central government and not municipal authorities*:** Informal workers have a high level of distrust in municipal authorities and would only be willing to participate in the system if it was administered by central government.

***To reduce fraud, the system needs to be clearly identifiable as a legitimate government initiative and easily recognisable*:** Participants felt that in addition to clear communication, there was a need for a clear logo and information on how to pay into the system to ensure that opportunistic individuals could not take advantage.

***Harmonisation of government policies and systems*:** Government policy pertaining to informal workers needs to be consistent. Protecting informal workers' access to income-earning activities is of utmost importance if informal workers are to be able to pay into the system. Their activities need to be supported, particularly at the municipal level where they currently experience considerable harassment. Current government systems could also be harmonised so that workers have the option of paying into the system from grants.

***Consultation with informal workers on the design and implementation of the 'new pension'*:** Participants made it clear that, in order for the mechanism to be accepted by informal workers, the government would have to consult more extensively with them on the design and implementation of the proposed mechanism, through their leaders or representatives. Participants also stressed the importance of consulting not only with young leaders but also with older leaders who may have more knowledge of the context and a more long-term understanding of the needs and challenges faced by informal workers.

The FGDs suggest that informal workers are certainly willing to pay into a contributory retirement system as the system addresses a current gap in the savings and insurance available to those in the informal economy. The challenge is to ensure that informal workers are adequately informed and that the system is designed in a flexible way that ensures workers have the ability to pay into the system.

Our study has also shown that, in order for the proposed mechanism to work and be accepted by informal workers, it should be transparent and non-punitive. It is essential that there is an understanding that the proposed mechanism is not designed to replace existing social protection mechanisms such as the SOAP. There needs to be clarity on the protection of the contributions that participants make, even in the event that they are no longer able to pay in their contributions to the mechanism. One of the key challenges is in asserting that the mechanism is designed primarily as a retirement provision mechanism and that, although the government is cognisant of the numerous challenges that informal workers face in accessing financial and other services, this mechanism cannot address all those challenges nor provide the associated services or benefits. Finally, there may be a need for the creation of a body that facilitates consultation between the government and informal workers so as to ensure that the proposed mechanism is acceptable and relevant to informal workers, both in terms of design and implementation.

6 Options for providing for informal workers' retirement

6.1 Introduction

One of the main outputs of this study was the development of a costing tool to allow for the assessment of different alternatives for including informal workers in retirement provisions in South Africa.

The options

The actuarial tool was used to develop four options, including the current government proposals for a mandatory system (i.e. the NSSF) as one of them. The details of the government proposals have not been fully specified so this chapter presents an option that mirrors the authors' understanding of the proposals as closely as possible. The four options outlined are a DB scheme and three different DC schemes, each with varying levels of guarantees and flexibility.

Separate options for disability benefits and benefits on death before retirement were developed. These benefits are payable to fewer people than are retirement benefits, and are generally funded through insurance or risk pooling rather than from members' individual contributions.

6.2 Criteria for assessing the suitability of options

There are many criteria against which options can be assessed. In this section a number of criteria are presented, and consideration is made to how they interact with each other. It is also important to view the criteria from the different perspectives of the member, employer and government, which will often conflict (for example, less risk for the government may mean more risk for the individual).

First, benefits may be more or less **attractive** to different scheme members. For example, lump sum benefits are often popular: people can understand their value, and if their timing and amount are reasonably predictable they can be used as security for loans. Life annuities (i.e. regular payments until death) may be more difficult to understand, and hence less popular, but may provide more **long-term security**. Some arrangements provide more **predictability** for members, for example by defining in advance both the amount and timing of benefit payments. The attractiveness might not necessarily maximise **social welfare**; the government may be concerned with ensuring certain benefits to minimise social inequality, which may not necessarily be the priority of the members.

Both benefits and contributions may be more or less **flexible**, and thus able to be varied at the option of the member or depending on their particular circumstances. However, flexibility can mean that benefits are more complex, or less **simple**, as well as being less predictable. A desire for simplicity may also make it more difficult to **tailor** separate schemes for different sub-sectors or industries. A simple scheme may be **managed** more **efficiently**, or be **cheaper** and easier to **administer**.

There are various ways in which schemes can promote **fairness** between members and **equity** for individual members. A scheme is fair if different members in similar circumstances receive similar benefits, and equitable if an individual member is not significantly better or worse off as a result of small changes in circumstances. It may also be desirable for the benefits under a scheme to be **consistent** with those under other schemes.

Simple and attractive benefits are often easier to **communicate** to members and potential members, whereas complex arrangements make communication more difficult. Ease of communication can also affect the level of **social awareness** of the scheme.

There are always **risks** inherent in schemes – primarily that the contributions will not be sufficient to pay for the promised benefits. The risks can manifest themselves in different ways, including poor investment performance, for example, or members having higher levels of disability or longer life spans than expected. A key element of scheme design is how the various risks are shared between the members, employers, scheme and government.

More generous benefits will be attractive to members but will cost more. Another key element of design is how the cost is split between the parties – typically, employees, employers and government. Benefits should also be appropriate: for example, a generous and costly pension might not be appropriate for poor people with limited resources who may have low life expectancy – a major advantage of a pension is that it reduces the financial risks of longevity for the recipient. Less well-off members might well place a higher priority on being able to meet their immediate needs. Table 6.1 summarises some of the interactions between criteria.

Table 6.1 Interactions between criteria

Criterion	Potentially reinforces	Potential conflict
Attractiveness	Appropriateness, predictability	Fairness, risk, cost
Flexibility	Tailor for different sub-sectors	Simple, efficient management, cheap to administer, fairness, ease of communication, cost
Long-term security	Social welfare	Attractiveness
Fairness	Equity, consistency	Flexibility, risk, cost
Ease of communication	Simple, attractive, social awareness	Risk, cost, flexibility
Risk	Cost, attractiveness	Attractiveness, flexibility, fairness, ease of communication
Cost	Attractiveness	Attractiveness, flexibility, fairness, ease of communication

According to the findings from previous chapters, the most significant criteria are likely to be attractiveness to members and ease of administration and communication. Cost to the government is also important.

6.3 Government proposals for the NSSF

This section summarises current understanding of the government proposals for the NSSF, although it should be stated that all the details have not been fully verified.

6.3.1 Contributions

There is a total contribution rate of 12% of salary, split equally between employer and employee. Of this 12%, 6% is intended to fund retirement benefits, 2% funds unemployment benefits, and the remaining 4% funds the other benefits.

Membership is optional for those with salaries lower than R13,000 per annum. There is a salary ceiling for contributions, which is currently set at R178,464.

The government subsidises the employee contributions for those with salaries less than R62,000 per annum. The subsidy is 100% (i.e. the government pays the full 6% contribution) for salaries between R13,000 and R24,000, and decreases linearly to 0% for salaries of R62,000.

6.3.2 Retirement benefits

A pension of 0.5% of career average salary for every year of membership will be paid on retirement at age 65. It is not clear whether the pension will increase during retirement. It is not clear whether any benefit is payable on death during retirement (such as a spouse's pension) in addition to a flat-rate lump sum payment (the amount of which is not specified).

6.3.3 Death before retirement

On death before retirement, benefits are payable to the member's spouse and children in the form of regular monthly payments. The spouse's benefit is payable for a limited period (which is not specified). The children's benefit is payable until they reach age 18 or complete their tertiary education. The amount of the payments will depend on the member's salary, but is not otherwise specified. There may be a cap on the total benefits payable in respect of a member, but this is not specified.

There will also be a flat-rate lump sum payment, although again the amount is not specified.

6.3.4 Disability

Ill health or disability benefits are payable if a member becomes permanently disabled. A regular payment, the amount of which is based on the member's salary, is paid until they retire, at which date they receive the normal retirement pension.

The amount of the disability pension is not specified. The amount of the retirement pension following the disability benefit is also not specified: it is possibly based on the member's salary at the date of disability, with the pension continuing to accrue until retirement date.

6.3.5 Unemployment

Unemployment benefit is payable for a maximum of 238 days. Members of the UIF earn one day of credit for every six days worked. The daily rate paid is known as the Income Replacement Rate, and varies between 60% and 38% of the daily wage.

6.4 Proposals

This section first presents four alternatives for retirement provisions for informal workers. Each proposal is discussed in terms of the criteria outlined in Section 6.2. Following that, several alternatives for ill health and death before retirement benefits are presented. These alternatives are not intended to be seen as final proposals, but rather represent the forms that the proposals could take. The final choice of the form and level of benefits will depend on the risk appetites and budgets of the parties involved, i.e. primarily the government but also the potential membership and employers.

6.4.1 Retirement benefits

Table 6.2 presents four options for retirement benefits for informal workers. In all cases it is assumed that members are entitled to the SOAP, currently a payment of R1,260.00 (from 1 April 2013) per month from age 60.

Table 6.2 Retirement benefits

	1. DB	2. Smoothed DC	3. DC pension	4. DC retirement bonus
Retirement age	65	65	65	65
Contributions (to cover all benefits, including risk benefits)	12% of salary, 6% from each of employee and employer	Member contributions matched by the government, up to a ceiling. 90% of contributions are paid into the retirement account	Member contributions matched by the government, up to a ceiling. 90% of contributions are paid into the retirement account	Member contributions matched by the government, up to a ceiling. 90% of contributions are paid into the retirement account
Contribution accumulation	N/A	75% of actual returns if positive, guaranteed non-negative	Actual returns on pooled contributions	Actual returns on pooled contributions
Lump sum on retirement	None	Up to 25% of retirement account	Up to 25% of retirement account	Up to 100% of retirement account
Pension	0.5% of average salary during membership for each year of membership, maximum of 50 years	Compulsory annuity bought from accumulated retirement contributions (retirement account) – at guaranteed rates	Compulsory annuity bought from accumulated retirement contributions (retirement account)	Optional annuity bought from accumulated retirement contributions (retirement account)
Pension increases	Inflation linked	Inflation linked	Depends on annuity chosen by member	N/A
Survivors' pension on death in retirement	25% of pension split between spouse and dependent children	25% of pension split between spouse and dependent children	Depends on annuity chosen by member	N/A
Lump sum on death in retirement	R10,000	Pension guaranteed for five years	Depends on annuity chosen by member	None
Advantages	• Attractiveness • Long-term security • Fairness • Low risk (to member)	• Fairness • Communication • Attractiveness • Long-term security	• Flexibility • Fairness • Communication • Low risk (to government) • Low cost	• Flexibility • Fairness • Communication • Low risk (to government) • Low cost
Disadvantages	• Lack of flexibility • Difficult communication • Risk (to government) • Cost	• Risk (to government)	• Attractiveness • Long-term security • High risk (to member)	• Attractiveness • Long-term security • High risk (to member)

6.4.1.1 Option 1 – DB

Option 1 is intended to mirror the current proposals for the NSSF as closely as possible. Where the details of the NSSF proposals are unclear, we have selected options that seem reasonable. A pension of 0.5% of career average salary for every year of membership will be paid on retirement at age 65. The pension will increase with inflation during retirement. A lump sum of R10,000 will be paid on death in retirement, with a survivors' pension of 25%.33

Option 1 provides long-term security to members, and some security to their dependants through the survivors' pension. It also provides predictability, as the pension that is payable depends only on salary level and length of membership, not on investment returns. It is not a flexible arrangement, as the benefits are fixed and cannot be varied. However, neither is it particularly easy to administer, as detailed records of employment history and salary levels must be kept, and somewhat complex calculations performed in order to determine the amount of pension that is paid. This is in part tempered by the fact that it matches the NSSF benefits, so the system that is set up for the scheme as a whole will not have to be adjusted for informal workers.

However, this arrangement is unlikely to be practicable for informal workers, as it relies on having a clear definition of the member's salary. Informal workers may have several part-time jobs, in some or all of which they are self-employed, and which may be seasonal. They thus do not have a fixed monthly salary, making it difficult to determine both the contributions they should pay and the benefits they should receive. In addition, it seems likely that many informal workers would be unwilling to reveal their income to an official or semi-official body, and that they would not participate in the scheme if doing so was a requirement. For these reasons, a DB scheme would be unsuitable for informal workers.

6.4.1.2 Options 2, 3 and 4 – DC options

The remaining three options are all based on the contributions of the member, which can be made at a level and frequency of the member's choosing. In all three arrangements, the government would match the members' contributions, Rand for Rand, up to a ceiling. Contributions are credited to an individual account administered by the scheme. The account will be credited with a share of the investment returns earned on the total pooled contributions. At retirement, the amount accumulated in the individual account is available to provide retirement benefits.

There are three main methods of providing retirement benefits from an accumulated account: a lump sum, an annuity, and draw-down of the account. These can be combined: for example, members may have the option of taking a proportion of their account as a lump sum, but must use the remainder to buy an annuity.

DC arrangements can provide long-term security to members (though not necessarily to their dependants) if the retirement account is used to buy an annuity. However, there is little predictability: the amount of the pension depends on the investment returns earned on the contributions, and on the price of annuities at the date of retirement. There is more flexibility than under option 1, as the member would be able to give up some pension by taking some of their retirement account as a lump sum.

The option to take a lump sum is likely to be attractive to members, as the lump sum could be used to pay off debts, purchase accommodation, or used as collateral for a loan. Buying an annuity is unattractive to some members, as they feel they will lose out if they die before they have received their money's worth from the annuity.

Drawing down from the account is a compromise between a lump sum and an annuity: the member specifies the draw-down period in advance, and then regular payments are made from the account so that the account is exhausted at the end of the period. If the member dies in the meantime, the remainder of

33 The amount of the lump sum paid on death in retirement under the proposals for the NSSF is unclear. It is not clear whether there is a survivors' pension under the NSSF.

the account is paid out to their dependants. Draw-down provides less long-term security to members than an annuity, as it provides no income after the end of the draw-down period. However, it is simple to explain.

It is possible to allow members to withdraw all or part of their retirement accounts early, before they reach retirement age. If early withdrawal is allowed with no penalties, then the scheme becomes more akin to a bank account than a retirement fund. However, the ability to withdraw funds early is often attractive to members. It is possible to allow limited withdrawals, for example up to a certain percentage of the retirement account over a specified number of years.

In the interests of simplicity and clarity options for draw-down or early withdrawals have not been included in the proposals, but it might be worth considering them as possible variations to the basic structures set out.

Administration of a DC arrangement will be challenging as full records of contributions need to be maintained, and it will not be possible to use the system used for the main NSSF benefits. The retirement benefits are less fair and equitable than those under option 1, as they are likely to depend on exactly when retirement occurs: two people who had made the same contributions could get very different pension amounts if they retired at different dates. Communication of the benefits is likely to be reasonably simple, possibly leading to good social awareness. The members bear the risk of poor investment performance and, especially with lump sum or draw-down options, the financial risks of living for longer than expected.

Within this overall structure, the details can be varied so that the risk is borne to a greater or lesser extent by either the government or the members. The primary risks are investment risk and longevity risk. The investment risk is that investment returns will be poor, or even negative, so that the funds available to the member at retirement will provide inadequate benefits or might even be less than the contributions the member has made. The longevity risk is that the retired member will live for longer than expected, and thus that their funds will run out. Investment risk can be addressed by providing guarantees of investment performance, thus shifting the risk (and some cost) to the guarantor, which in this case would be the government. Longevity risk (and post-retirement investment risk) can be addressed by requiring some or all of the retirement account to be used to buy an annuity, thus shifting the risk to the insurance company or other body providing the annuity.

6.4.1.3 Option 2 – smoothed DC

Option 2 is a DC scheme with smoothed returns. The purpose of this option is to combine the flexibility and simplicity of a DC scheme with some guaranteed elements that mean the government, or the scheme as a whole, share some of the individual members' risk. Under this option, the members bear more risk than under option 1, but less than under options 3 and 4.

Rather than being based directly on the actual investment returns, the scheme will guarantee that the rate of return will never be negative, so the amount of an individual retirement account can never decrease.[34] However, if the actual rate of return is positive, only 75% of it will be credited to the retirement account.

At retirement, the member must use at least 75% of the value of the account to buy an annuity, and may take the remainder as a lump sum. The terms on which the retirement account is converted into an annuity will be guaranteed, and only limited annuity options will be offered. The pension will increase with inflation

34 The guarantee is expressed in terms of the nominal return – i.e. the headline rate. In times of inflation, the real return could be negative: if the amount in the retirement account stays the same, it would be worth less as result of inflation.

during retirement, and will be guaranteed for five years. A survivors' pension of 25% will be paid on death in retirement.

The smoothed investment returns provide some predictability to members, as do the guaranteed annuity returns. However, the requirement to buy an annuity, and the limited range of options, limit the flexibility. The investment smoothing also introduces an element of complexity that may make communication less easy. There is a slight risk of insolvency if actual investment returns are consistently poor, or if the guaranteed annuity terms are too advantageous to members.

6.4.1.4 Option 3 – DC pension

Option 3 is a basic DC scheme with no smoothing of investment returns. In some years the value of the account may decrease, if investment returns are negative. At retirement, the member must use at least 75% of the value of the account to buy an annuity, and may take the remainder as a lump sum. The member will be able to choose what type of annuity they buy, i.e. whether it has a guaranteed period, includes a survivors' pension, or increases during payment.

Option 3 provides more flexibility to the member than option 2, in return for providing less long-term security and predictability.

6.4.1.5 Option 4 – DC retirement bonus

Option 4 is also effectively a DC scheme, but instead of using the proceeds of the account to buy a pension, the member receives a lump sum payment at retirement. This option is thus similar to a provident fund.

Option 4 is even more flexible than option 3, but provides less long-term security and predictability. However, it may be attractive to some members, as the lump sum payable on retirement could be used to pay off debts or purchase accommodation. In addition, experience in other countries shows that lenders are often willing to accept the entitlement to a lump sum as collateral for a loan. Administration would be easier than for options 2 and 3, as there would be no requirement to ensure the purchase of an annuity.

6.4.2 Risk benefits

The split between DB and DC is less marked for risk benefits, such as disability and death benefits, than it is for retirement benefits. Most DC schemes incorporate elements of insurance for these benefits. The probability that an individual will suffer death or disability before retirement is low but if they do the consequences are obviously severe, so individuals benefit from risk pooling. This contrasts with retirement benefits, for which the argument for risk sharing is weaker: the main risk for an individual is longevity.

These options are presented as independent of the retirement benefit options since it is entirely appropriate for schemes with DC retirement benefits to incorporate DB, or at least insured, disability and death benefits.

If risk benefits are not closely related to contributions, there is a possibility that the scheme will suffer adverse selection: people in poor health could become members because they anticipated that they or their survivors would soon be in receipt of risk benefits. The benefits payable could be worth many times the contributions that had been made, resulting in a significant financial strain on the scheme. It is therefore proposed that there be a vesting period of three years: in the first three years of membership, disability or death would result only in the payment of the accumulated retirement account.

6.4.2.1 Disability

Benefits will be payable if a member becomes permanently disabled. They could be funded either by buying insurance cover or by pooling contributions from all members.

A major problem with disability benefits is that of defining what is meant by permanent disability, and determining whether a member is eligible to receive the benefits. The cost of providing benefits is extremely sensitive to the numbers of members claiming them.

There are two main forms that benefits can take: pension or lump sum. Both pension and lump sum could be defined in terms of the member's salary, recent contributions or retirement account, or as a flat rate: for example, an annual pension of three times the contributions paid over the last three years, or a lump sum of 1.5 times the retirement account. In this report, disability benefits are not defined in terms of salary, for the reasons outlined above.

Paying a pension on disability provides long-term security to the member. However, there is risk (and cost) to the government in relation to members who become disabled early in their careers and who then live for a long time. A disability pension defined in terms of recent contributions, or as a flat rate, could lead to anomalies: a member suffering disability close to retirement age could find their financial situation significantly better or worse than expected, depending on their length of membership or the value of their accumulated contributions. It thus lacks equity. However, it would be reasonably simple to administer.

Instead of (or as well as) providing a disability pension, a lump sum could be paid on disability. This would be easier to administer, as a one-off payment is simpler than an ongoing pension. It might also be attractive to members, allowing them to buy medical equipment, for example, but does not provide the same long-term security as a pension. The member would not receive the same retirement benefit as if they had not been disabled.

Table 6.3 Disability benefits

	1. DB	2. Smoothed DC	3. DC pension	4. DC retirement bonus
Vesting period	None	3 Years	3 Years	3 Years
Pension (payable until retirement)	Pension that would have been payable had the member continued on the same salary until retirement	Annual pension of 1.5 times the contributions paid in the last three years	Annual pension of 1.5 times the contributions paid in the last three years	None
Pension increases	Inflation	Inflation	Inflation	None
Lump sum payable on disability	None	None	None	Two times the amount of the retirement account
Contributions paid into retirement account	None	10% of pension payments	10% of pension payments	10% of lump sum payment

There are two components to disability benefits: first, benefits that are paid during what would have been the working life of the member, until they reach retirement age, and, second, benefits that are paid from retirement age. For the DC options, disabled members are unlikely to be able to continue to pay contributions themselves. One of the benefits suggested is therefore a contribution that is credited to the member's retirement account, where it will accumulate as normal. The benefits on retirement would be based on the retirement account in the usual way. These extra contributions to the retirement account would be credited directly by the scheme, and would be in addition to the disability pension or lump sum. Table 6.3 shows the disability benefits proposed.

6.4.2.2 Death before retirement

Benefits will be payable if the member dies before reaching retirement age. As with disability, it would be possible to pay a pension (in this case to the deceased member's survivors) or, or as well as, a lump sum. Unlike disability, the determination of eligibility is not a major problem.

There are two main forms that benefits can take: pension or lump sum. Both pension and lump sum could be defined in terms of the member's salary, recent contributions, or retirement account, or as a flat rate: for example, an annual pension of three times the contributions paid over the last three years, or a lump sum of 1.5 times the retirement account. In this report, death benefits are not defined in terms of salary, for the reasons outlined above.

If the member died shortly before retirement, and had not been a member of the scheme for long, the survivors' benefits could be significantly more valuable than the retirement benefits that the member would have received had they survived. However, if the member had a large retirement account built up under one of retirement options 2 to 4, or no eligible spouse or children, the value of the benefits could be significantly lower than the retirement benefits.

Paying a pension would provide some long-term security to the deceased member's dependants. A lump sum could be used for funeral expenses, a benefit that is likely to be attractive to members.

Table 6.4 presents the death benefits as recommended.

Table 6.4 Death benefits

	1. DB	2. Smoothed DC	3. DC pension	4. DC retirement bonus
Vesting period	None	3 years	3 years	3 years
Lump sum	R10,000	R10,000	R10,000	R10,000 plus 7.5 times the contributions paid in the last three years
Survivors' pension	Annual pension of 25% of the member's salary	Annual pension of 1.5 the contributions paid in the last three years	Annual pension of 1.5 times the contributions paid in the last three years	None

6.5 Benefit illustrations

In this section the benefits provided by the four retirement options described above are compared.

There are two main ways in which the benefits can be compared: in terms of replacement ratios and in terms of the value of retirement benefits. There are difficulties with both comparisons, meaning that only approximate comparisons between DB and DC arrangements are possible.

The replacement ratio measures the proportion of pre-retirement salary that is replaced by post-retirement pension. There are two difficulties: first, there is no well-defined salary for informal workers and, second, the amount of pension that a DC scheme provides depends on annuity rates at the time of retirement. As described in Annex B, it is not possible to estimate with any reliability the annuity rates that will be available to retirees in the future. This means that replacement ratios for DC benefits are very sensitive to assumptions about the proportion of income that members contribute to the scheme, as well as to assumptions about annuity rates.

The value of retirement benefits, on the other hand, is easy to determine for DC arrangements but difficult for DB arrangements such as retirement option 1. The pension can be valued in terms of an equivalent annuity, which of course depends on annuity rates.

As a basis for comparison, consider a member aged 45 when they join the scheme, with an annual salary of R24,000 (for DB) or a monthly contribution of R100 (for DC). Further, their salary and contributions increase by 1% more than inflation each year, with inflation at 4.5% a year, and an investment return averaging 2% more than inflation.

6.5.1 Replacement ratios

A useful indicator of the adequacy of retirement provision is the replacement ratio: how much of the member's pre-retirement income is replaced by their pension. In the simplest case, ignoring taxation, the replacement ratio is simply the pension amount divided by the pre-retirement salary. Replacement ratios take only retirement benefits into account, ignoring risk benefits (i.e. benefits on disability or death before retirement).

The replacement ratios for the DC options depend crucially on three assumptions: first, the relationship between salary and contributions; second, the terms on which a lump sum can be converted to a pension (the annuity rate); and third, on the assumed investment returns. These assumptions are the same for all three DC options, so comparisons of replacement ratios between the DC options are meaningful, if somewhat artificial – there is no obligation to buy an annuity under option 4. The replacement ratio for option 1 (DB) is fixed by the design of the benefits, which are defined in terms of the member's salary. The rates of investment return that must be achieved for the scheme to be financially sustainable are unknown, and may well differ from the investment returns assumed for the DC options. In addition, the effective annuity rates may well be different from those assumed in calculating the DC replacement ratios.

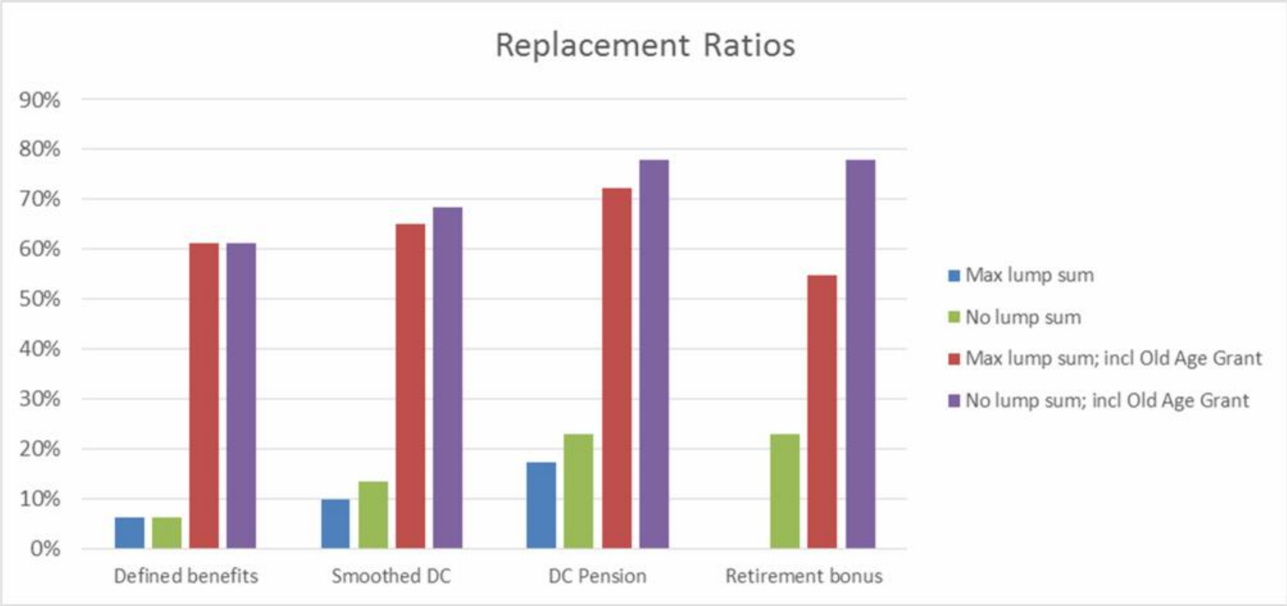
Any comparisons between option 1 and the other options must be treated cautiously. While the replacement ratio for option 1 is defined in the formulae and hence guaranteed, that of the other options is a projection based on our assumptions, so in reality could be higher or lower than the value. These comparisons are included as replacement ratios are a widely accepted measure of benefit quality, but the difficulties of calculating them for the DC options mean that too much weight should not be put on them.

Figure 6.1 shows the replacement ratios for the four options described above, both including and excluding the SOAP and showing both the minimum pension (i.e. if the member takes the maximum possible optional lump sum on retirement) and maximum pension (no lump sum).

It is evident that the SOAP is a significant source of retirement income for those at this income level. Without the SOAP, the replacement ratio is between 9% and 26% if no lump sum is taken; with it, the ratio is between 64% and 81%. For options 2 and 3 (smoothed DC and DC pension) the option of taking some of the retirement account as a lump sum reduces the replacement ratio by less than 10 points.

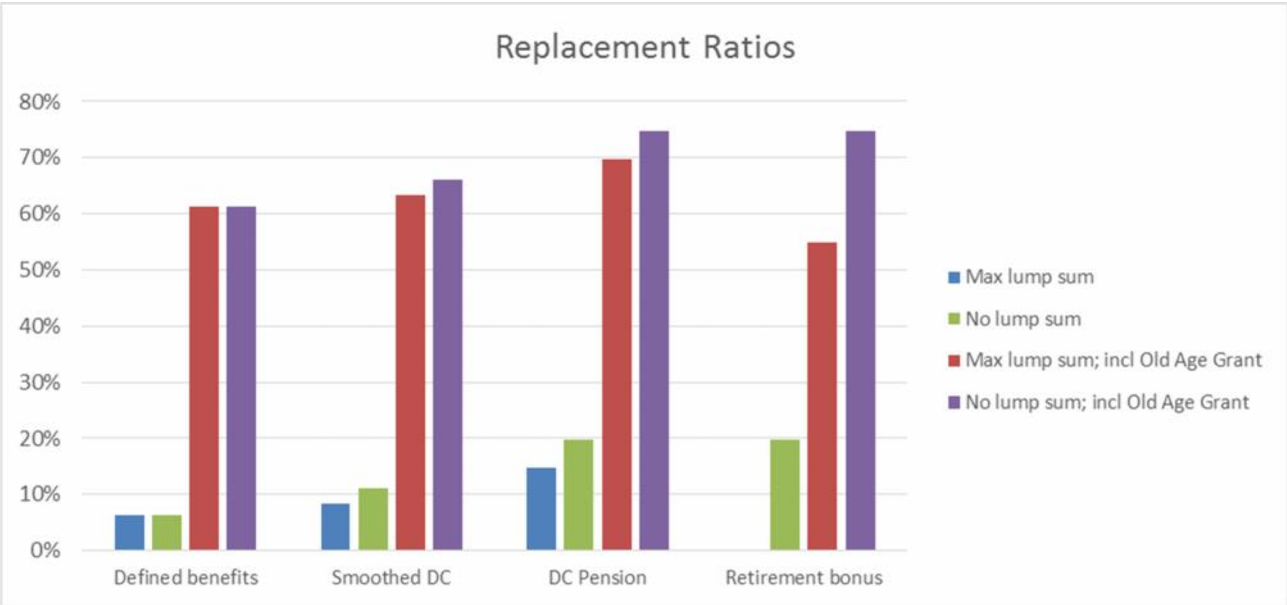
Options 3 and 4 (DC pension and DC retirement bonus) give higher pensions than option 2 (smoothed DC) for two reasons: the smoothing gives a lower overall rate of return, and option 2 requires the purchase of a more expensive annuity (including inflation-proofing, a five-year guarantee and a survivors' pension). The retirement account accumulates to the same value under options 3 and 4, so the maximum pension is the same. The smoothing in option 2 lowers the investment risk to the member, and the more expensive annuity lowers the member's longevity risk.

Figure 6.1 Replacement ratios for a male aged 45, salary R24'000, DC contributions 5%.



Because annuities are more expensive for women than for men, their replacement ratios are slightly lower (see Figure 6.2).

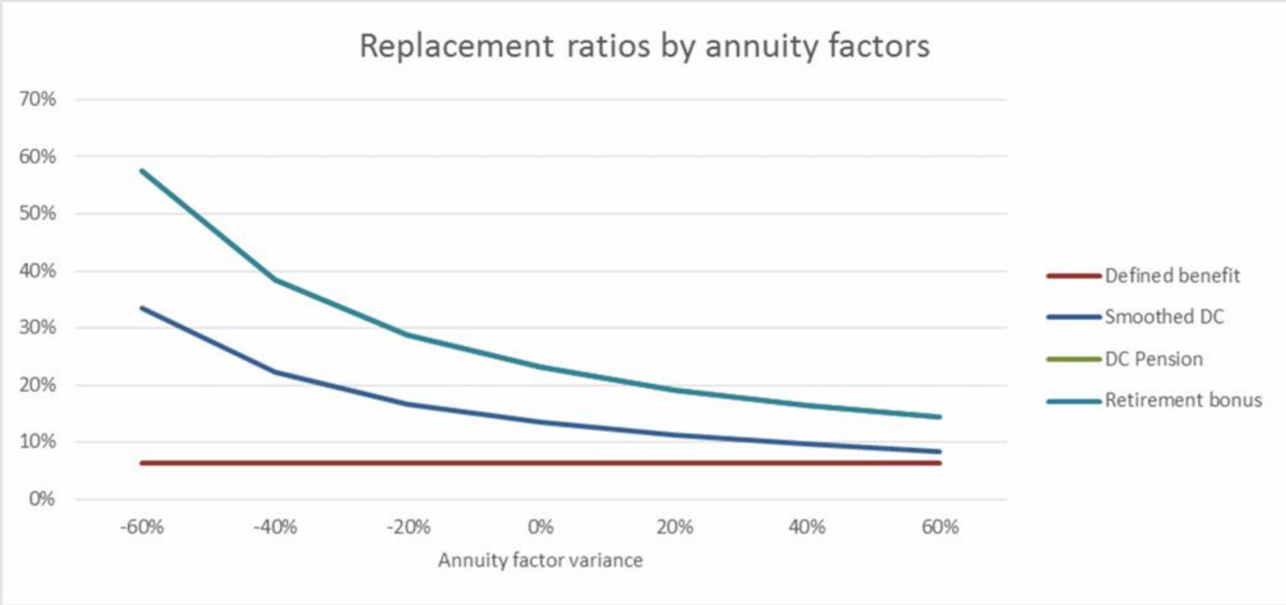
Figure 6.2 Replacement rations for a female aged 45, salary R24,000, DC contributions 5%



The replacement ratios for options 2, 3 and 4 (the DC options) depend on the terms on which it is assumed that members will be able to buy annuities.

Figure 6.3 shows the sensitivity of replacement ratios to annuity rates. The ratios exclude the SOAP, and assume that no lump sum is taken. Because the pension under option 1 (DB) is defined in terms of salary, the replacement ratio does not vary. The pensions under options 3 and 4 (DC pension and DC retirement bonus) are identical.

Figure 6.3 How replacement ratios vaary with different annuity rates

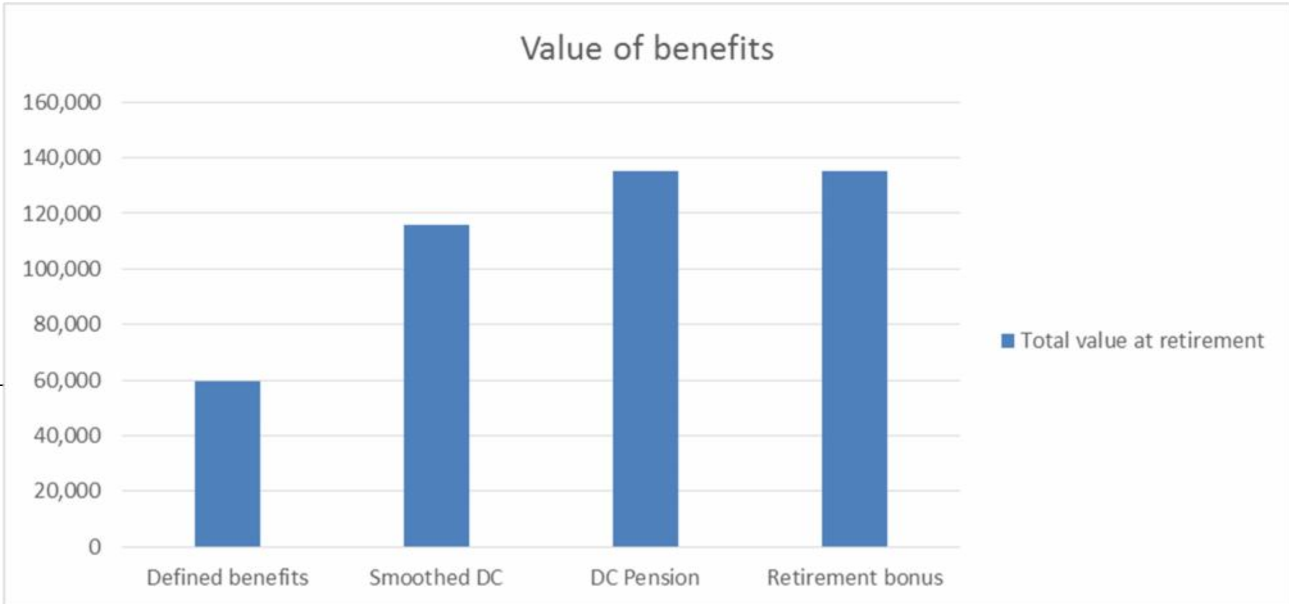


6.5.2 Value at retirement

Figure 6.4 shows the total value of benefits at retirement for all four options. The difference between options 2, 3 and 4 results entirely from the different rates of accumulation of the retirement fund. The benefits under option 1 are converted into a lump sum value using annuity factors. The value of benefits at retirement does not take risk benefits into account.

Comparisons of values of benefits at retirement under the different options are subject to similar caveats as comparisons of replacement ratios. It is straightforward to calculate values for the DC options (options 2, 3 and 4) – they are simply the value of the retirement account. The value of the benefits under option 1 (DB), however, requires a set of assumptions – in particular it depends on the expected annuity rates at the time of retirement. The comparison must therefore be treated with caution.

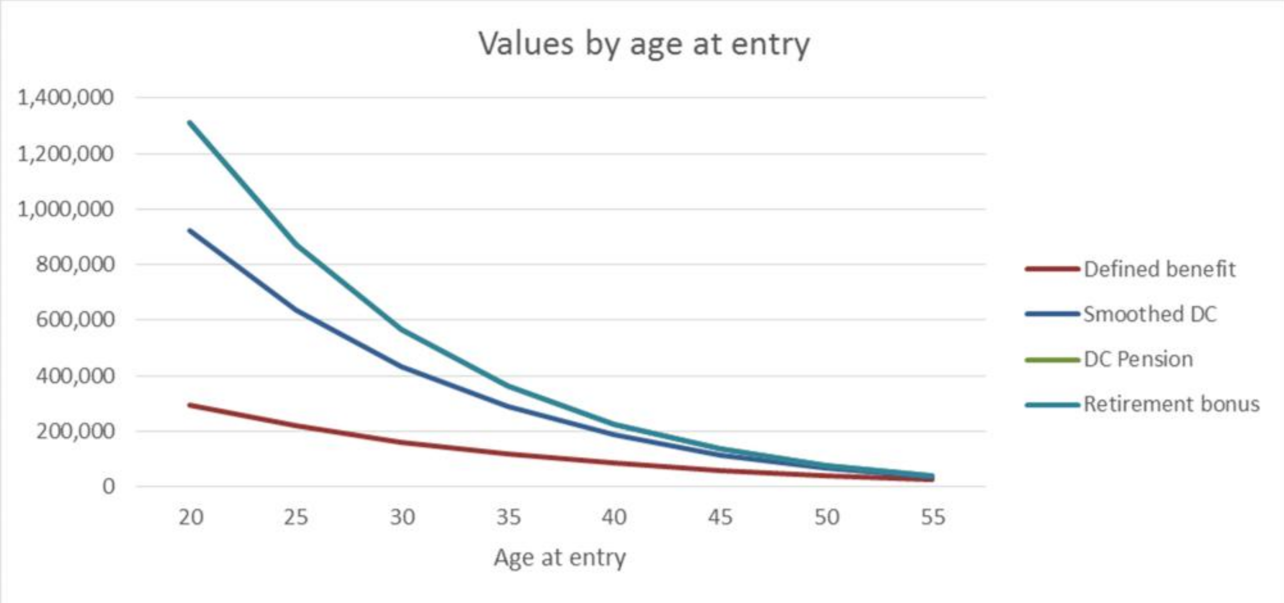
Figure 6.4 Value of benefits at retirement



6.5.3 Duration of membership

The retirement benefits that are payable depend crucially on how long a member is in the scheme. A person who contributes for only a few years accrues a much smaller pension than one who contributes for decades. This is true of both DB and DC options, as shown in Figure 6.5. Again, the values for DC pension and DC retirement bonus are the same.

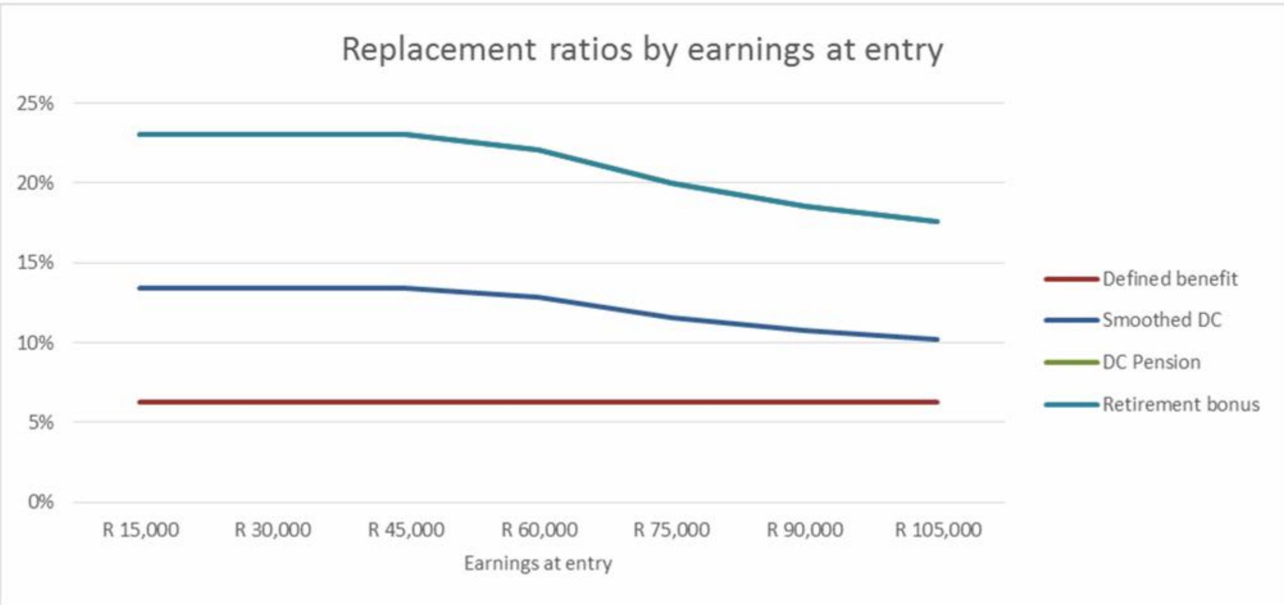
Figure 6.5 The effect of membership duration



6.5.4 Contributions and earnings level

Replacement ratios also depend on the contributions level. For the DC options, it is assumed that the government matches contributions up to a ceiling of R3,000 per annum, and that the maximum permissible contribution is R20,000 per annum (these correspond to earnings levels of R60,000 and R400,000 respectively).

Figure 6.6 The effect of earnings levels

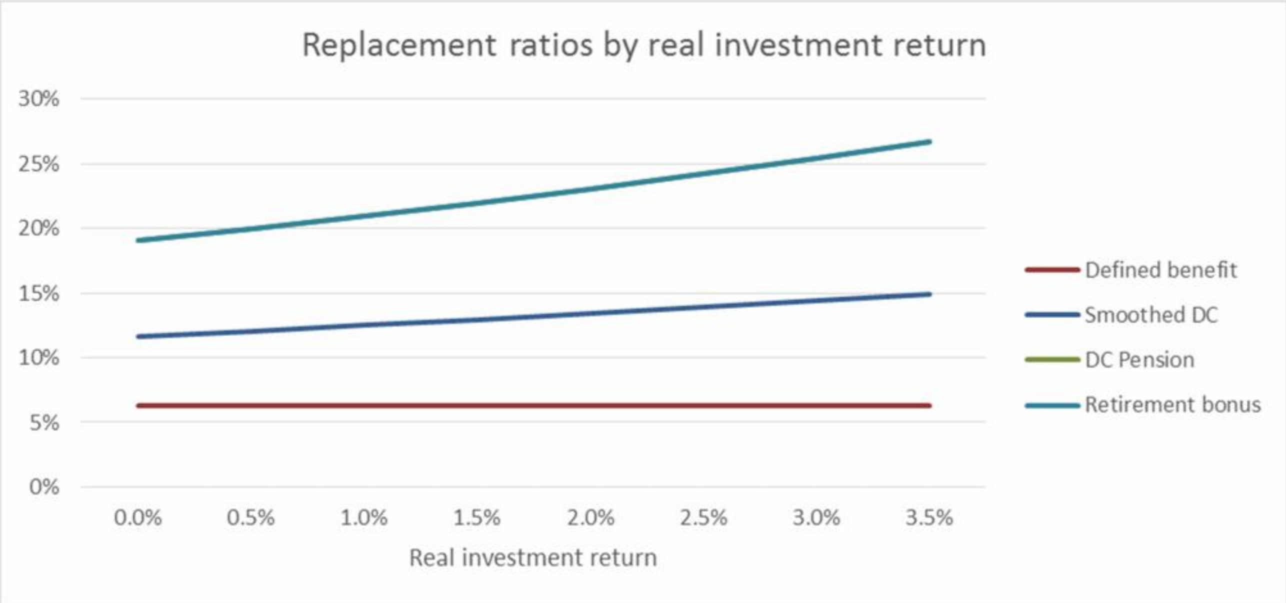


The effects of the ceiling on matching can be seen above in Figure 6.7. Because contributions are assumed to increase by more than inflation, contributions that are below the ceiling when the member enters the scheme may rise through the ceiling at a later date, so a lower proportion of contributions are matched by the government, thus leading to a lower replacement ratio.

6.5.5 Investment returns

The retirement benefits payable under the DC options depend crucially on investment returns, as shown in Figure 6.8

Figure 6.7 The effect of investment returns



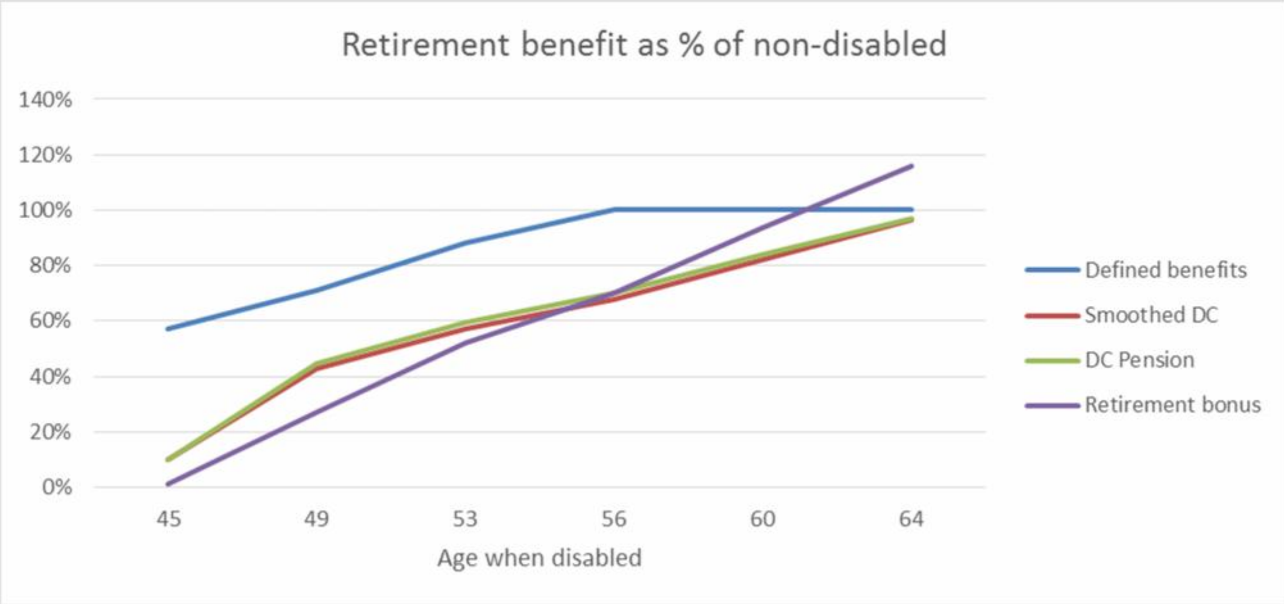
The benefits under option 2 (smoothed DC) are affected less because less of the investment return is credited to the retirement account.

6.5.6 Disability benefits

Under the DB option, the disability pension is the pension that would be payable if the member continued on their current salary until retirement. The retirement pension is the same as the disability pension. Under the DC options, further contributions are paid into the retirement account, which continues to accumulate and is paid out at retirement in the usual way. Figure 6.8 shows the retirement benefit as a percentage of what it would have been had disability not occurred, for a male entering the scheme at age 45. If disability occurs soon after entry to the scheme, retirement benefits are comparatively low[35] for the DC options. However, if disability occurs shortly before retirement, there is little effect.

35 If disability occurs within three years of joining the scheme (the vesting period), there are no benefits at retirement.

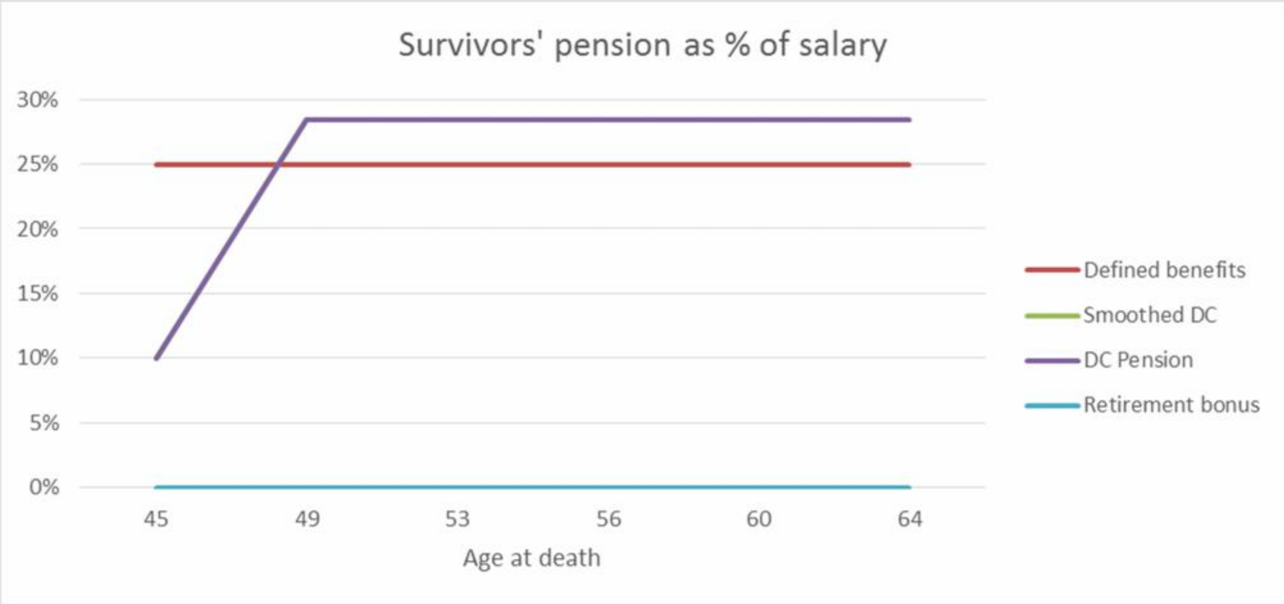
Figure 6.8 Retirement benefits after disability



6.5.7 Death benefits

Survivors' pensions are payable to spouses and dependent children who are still in full-time education. Under the DB option, a total of 25% of salary may be paid as survivors' pensions, while under options 2 and 3 (smoothed DC and DC pension) a survivors' pension of twice the contributions paid by the member in the last three years may be paid if death occurs at least three years after joining the scheme. If the member contributes 5% of salary, this gives a survivors' pension of up to 30% of salary, depending on the inflation level, as shown in Figure 6.9.

Figure 6.9 Survivors pension on death before retirement



6.6 Cost

In light of the discussion in the previous sections, it is recommend consideration of a DC scheme with smoothed investment returns, as well as death and disability benefits based on recent contributions. In this section, initial costings based on the benefits described in Table 6.5 are presented. However, it should be noted that the tool developed for this project can be used to model other sets of benefits if required.

Table 6.5 Costed benefits

Retirement age	65
Matching contributions from government	100% up to R2,000 per annum (inflating)
Proportion of contributions credited to retirement account	90%
Minimum investment return credited to retirement account	0%
Percentage of investment return over the minimum credited to retirement account	75%
Disability pension	1.5 times the contributions made by the member in the last three years, payable until age 65, plus a contribution of 10% of each payment to the member's retirement account if disability occurs more than three years after joining the scheme
Disability lump sum	The value of the retirement account if disability occurs less than three years after joining the scheme
Survivors pension on death before retirement	1.5 times the contributions made by the member in the last three years, if death occurs more than three years after joining the scheme
Lump sum on death before retirement	R10,000 (inflating), if death occurs more than three years after joining the scheme, or the value of the retirement account if death occurs less than three years after joining the scheme

NB: The effects of guaranteeing the annuity rates at retirement were not considered.

Following on from the analysis in Chapter 4, it is assumed that most workers in the informal economy earn between R200 and R3,000 per month (R2,400 to R36,000 per year), and that they might contribute, say, 5% of their earnings. This would result in monthly contributions of between R10 and R150 per month.

It is also assumed that there is an inflation rate of 4.5% per annum and a real investment return of 2% net of costs (i.e. a total investment return of 6.5% per annum after the costs of fund management).

Finally, in addition to matching members' contributions, it is assumed that the government makes an extra initial investment to fund the risk benefits (death and disability). This initial investment is assumed to be R1 billion a year for three years.

6.6.1 Membership profile

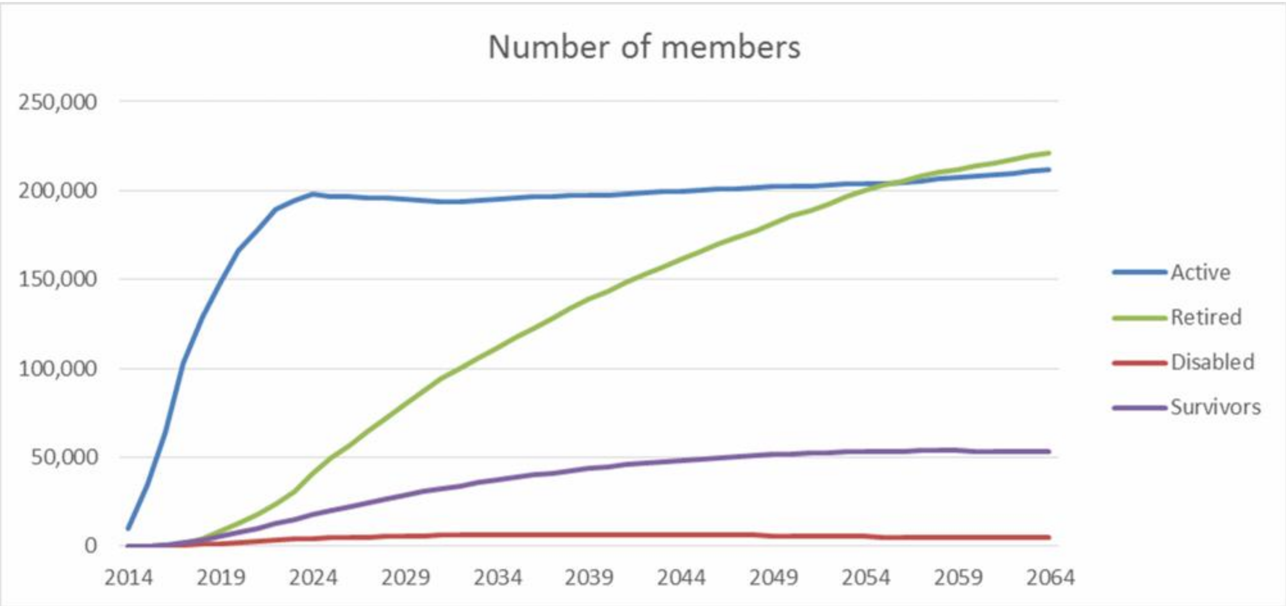
To estimate the cost of providing benefits, it is assumed that a mix of members join the scheme each year. Half the members are male, and half female. Three scenarios are considered:

- Scenario 1 – Medium take-up: total membership of scheme reaches around 200,000 after about 10 years, and remains stable thereafter. The average contribution level is between R50 and R75 per month (with the older members contributing at higher levels).
- Scenario 2 – Low take-up: the stable level of membership is about 100,000, with the average contribution level between R125 and R150 per month.
- Scenario 3 – High take-up: the stable level of membership is about 300,000, with the average contribution level between R40 and R60 per month.

The actual number of members who join the scheme and the level of their contributions will of course depend on a large number of factors, including the state of the South African economy, the growth or otherwise in informal employment, and how attractive the scheme is to workers – this number is essentially unknowable until the scheme is actually implemented.

Figure 6.10 shows the numbers of members under scenario 1. The number of retired members exceeds the number of active members after around 40 years.

Figure 6.10 Members under scanaio 1



6.6.2 Scheme projections

The financial state of the scheme under the three scenarios described above, and using the assumptions already described is shown in Table 6.6.

Table 6.6 Projection assumptions

Assumption	Value
Inflation	4.5%
Real investment returns	2% (net of investment management costs)
Contribution growth in addition to inflation	1%–2% (varies among members)
Mortality	90% of the population mortality rates published by the WHO in 2011, improving at 2% pa +4 years for disabled
Disability	30% of mortality rates
Survivors	Same age and opposite sex as deceased member. All members are assumed to have survivors
Administration costs	2% of total contributions plus 4% of risk benefit payments plus R500 (inflating) for each member who retires

NB: It is assumed that the scheme is divided into two funds: the retirement fund and the risk fund.

The retirement fund provides retirement benefits, and is funded by 90% of total contributions (members' contributions and the matching contributions from the government). When a member reaches retirement age, it is assumed that the retirement fund pays them the value of their retirement account. The effects of the scheme providing guaranteed annuity rates have not been modelled

The income into the retirement fund is thus 90% of total contributions plus the investment returns on its total assets. It incurs administration costs, and pays out the accumulated retirement accounts when members retire. When a member becomes disabled or dies, the amount of their retirement account is transferred into the risk fund. The returns credited to members' retirement accounts are 75% of the actual investment return (net of investment management costs) with a minimum of 0%. This provides a margin that is intended to cover the administration costs. However, if the administration costs are higher than anticipated, or actual investment returns are poor (especially if the minimum is activated), the retirement fund can go into deficit – in other words, its net assets can be less than the total value of retirement accounts.

The risk fund provides benefits on death and disability, and is funded by the remaining 10% of contributions, by an initial investment from the government, and from the retirement accounts of members who do not reach retirement. It is assumed that all risk benefits are paid from the risk fund as they fall due: in other words, the fund does not use annuities to fund survivors' pensions.

It is also assumed that members leave the scheme only when they retire or die, and that they cannot withdraw their retirement accounts before they reach retirement age. It is possible that the financial viability of the scheme would be adversely affected if early withdrawals were permitted, as people could, for example, time their withdrawals to gain the maximum advantage from the investment guarantees. Early withdrawals could also result in heavier administration costs.

The financial situation of the fund for 50 years was projected. The assumptions on which the projections are based are founded on little data as no equivalent scheme currently exists, and the projections are therefore at best indicative. The figures for the later part of the projection period are more speculative than those for the earlier part.

Our initial results, based on the medium take-up scenario described above, indicate that:

- the fund as a whole is self-supporting over the next 45 years;
- the assets in the retirement fund track the value of members' retirement accounts reasonably closely; but
- are generally lower (i.e. the retirement fund could be said to be in deficit);
- the assets in the risk fund start to decline after about 40 years.

Table 6.7 shows some key results from the projections, and the three subsequent figures the projected assets for each of the scenarios.

Table 6.7 Scenario 1 projections (whole fund, millions)

Year	Member contributions	Government contributions	Investment income	Benefit payments	Costs	Total assets at end	Retirement accounts at end
2015	30	1,030	102	2	12	2,195	71
2019	158	158	288	51	61	4,767	878
2024	272	272	486	292	102	7,837	2,813
2034	478	478	1,001	855	168	15,863	8,091
2044	871	871	1,712	1,839	278	26,812	16,070
2054	1,648	1,648	2,818	3,744	458	43,610	30,557
2064	3,184	3,184	4,734	6,469	769	73,503	60,352

As described below, the financial health of the scheme may be adversely affected by different membership profiles, by lower investment returns or heavier rates of mortality and disability, and by higher administration costs.

Scenarios

The financial results of the fund are very sensitive to the membership profile. The following three figures show the assets under the three scenarios described above: medium take-up, low take-up with higher contribution levels, and high take-up with lower contribution levels. The absolute numbers of members have little effect on the dynamics: doubling the membership effectively doubles the size of the fund, if the membership profile remains constant.

The first two scenarios give somewhat similar results, although the retirement fund is in a healthier state under scenario 2, which has higher contribution levels.

Under scenario 3, which has lower contribution levels, the assets in the retirement fund are consistently less than the total value of retirement accounts and the risk fund's assets start to decline after 30 years and are exhausted after 40 years.

Figure 6.11 Scenario 1 (medium take-up)

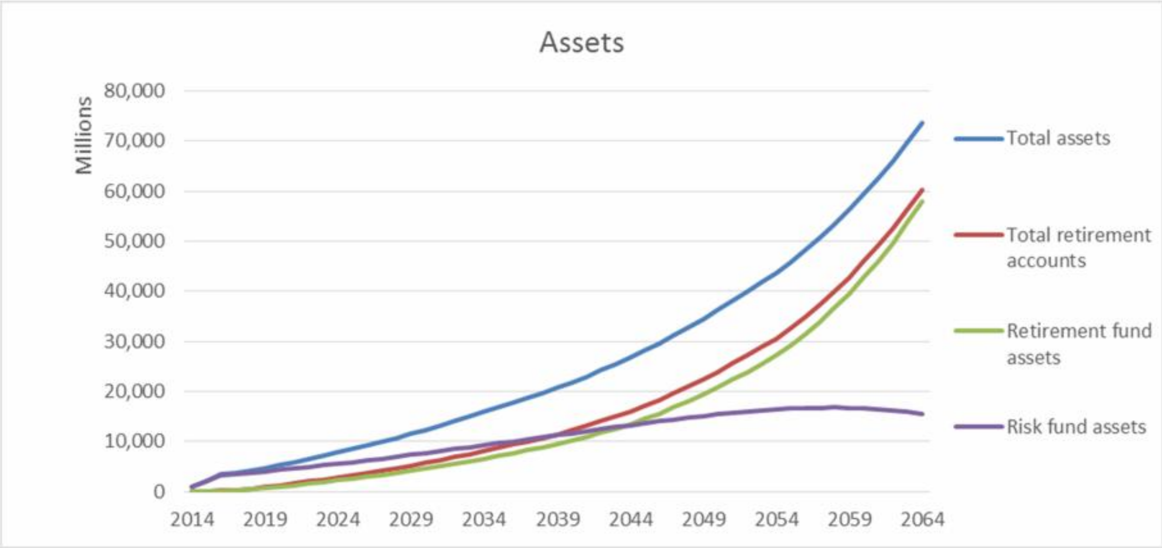


Figure 6.12 Scenario 2 (low take-up)

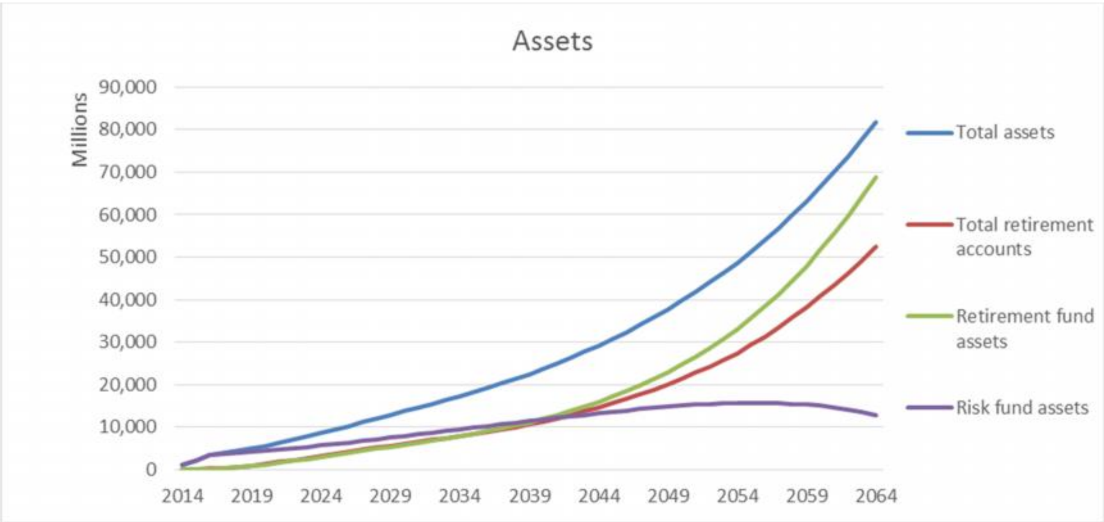
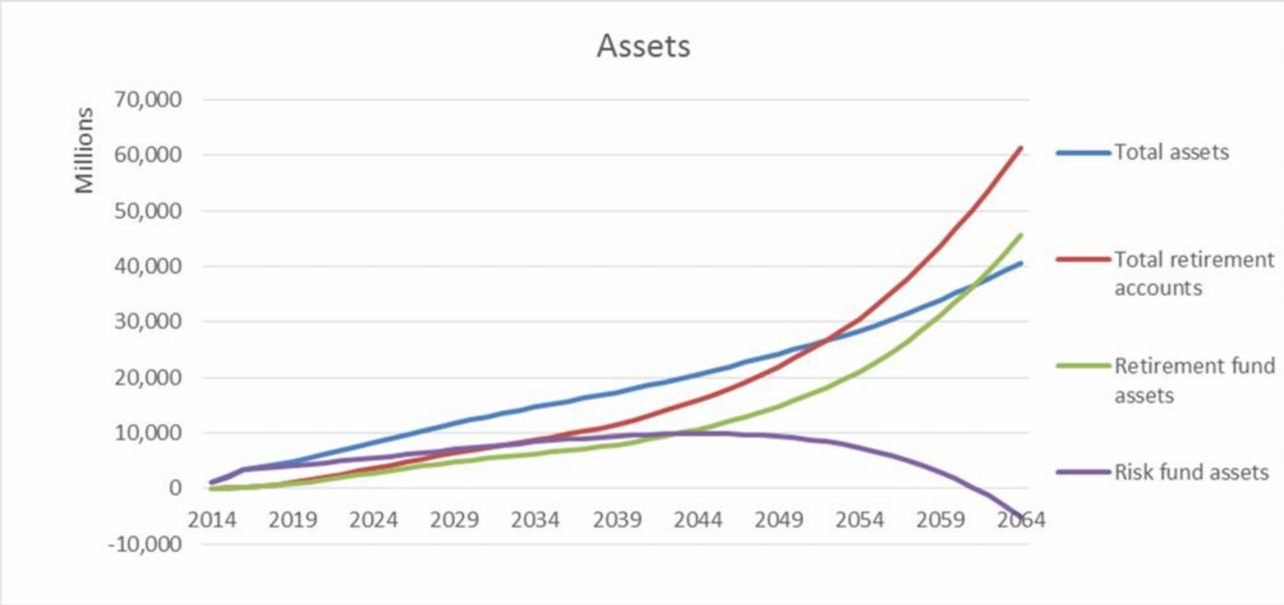


Figure 6.13 Scenario 3 (high take-up)



6.6.3 Risk fund options

As stated above, our projections indicate that the assets in the risk fund will start to decline after about 40 years. The time at which this happens varies according to the assumptions (see below). Although the projections are by no means precise, especially toward the end of the projection period, it possible that the risk fund would not be self-sustaining in the long term if it operated exactly as modelled here.

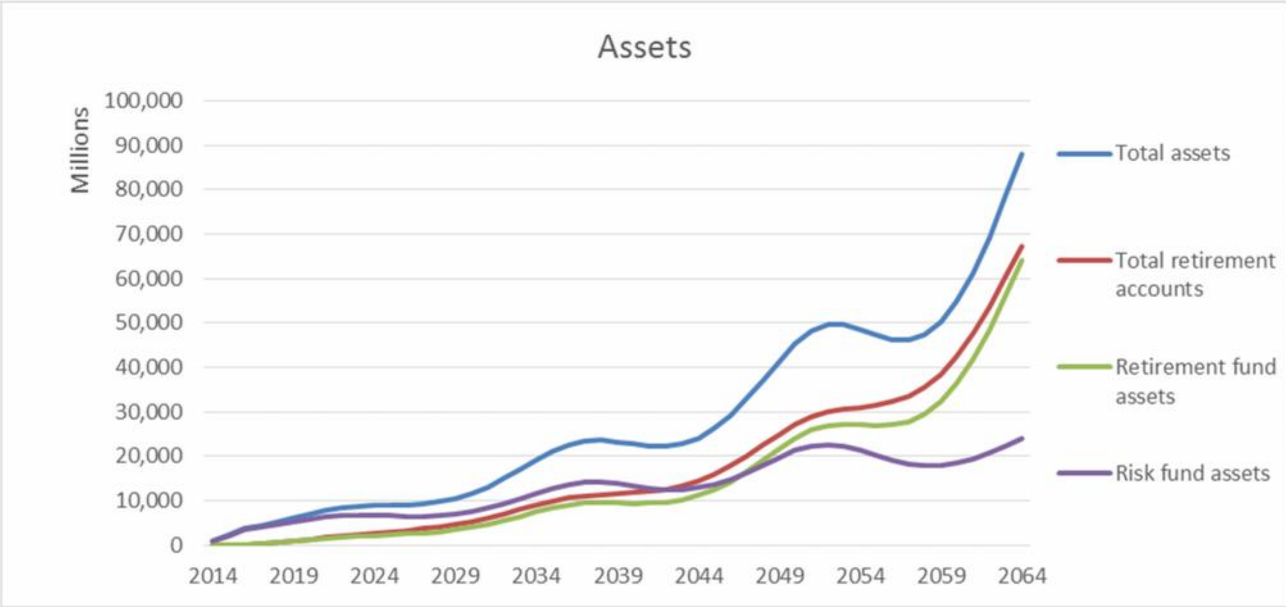
Increasing the initial cash injections from the government would delay the time at which the assets become exhausted, and might result in long-term self-sufficiency. The success of this course of action would depend crucially on the investment returns earned by the fund's assets.

Given the high levels of uncertainty around the levels of scheme membership and member contributions, mortality and disability rates, and investment returns, another possibility is to build in formal reviews of contribution and benefit levels at stated intervals. This would allow the scheme to be adjusted according to its actual experience.

6.6.4 Actuarial assumptions

Investment returns have a significant influence on the projection results. Figure 6.14 shows the effect of assuming that the real return (in excess of inflation) varies between 9.5% and -5.5% over a cycle of 15 years (i.e. the total return varies between 14% and -1.5%). The retirement fund assets are consistently less than the total value of retirement accounts.

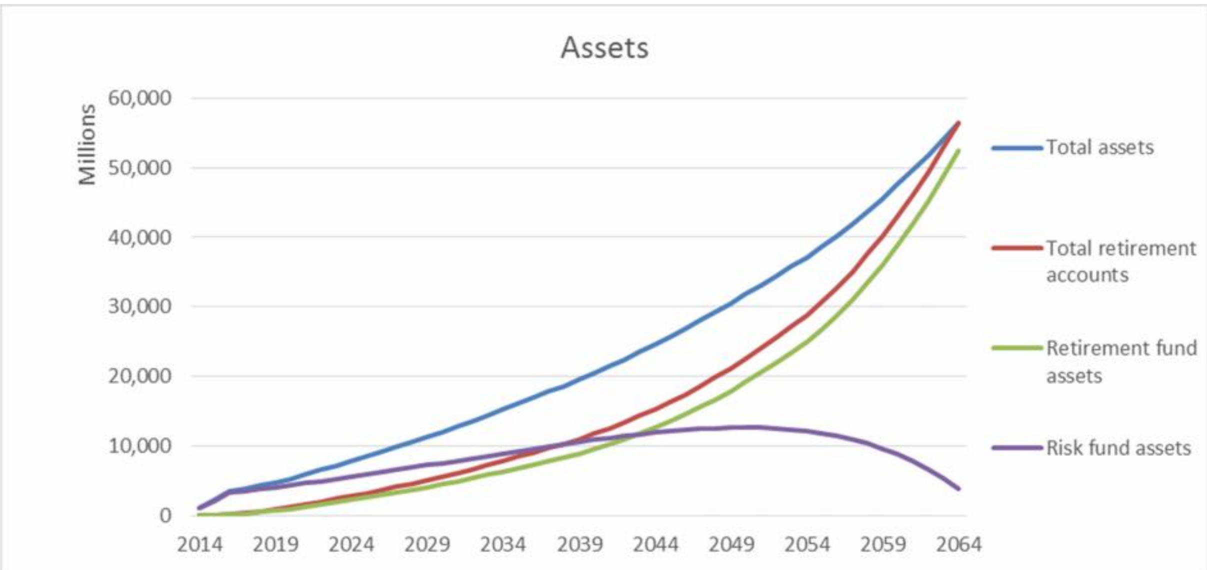
Figure 6.14 Varying investment returns



If the investment return is less than assumed in the central projections, at just 1% above inflation, the risk fund starts to decline after around 35 years and is exhausted after around 40 years. An investment return of 3% above inflation, on the other hand, means that the risk fund would continue to increase throughout the projection period.

In the base projections it is assumed that mortality rates improve at 2% a year. We investigated the effects of heavier mortality by assuming a 1% improvement rate. As it is assumed that disability rates are related to mortality rates, this also results in heavier disability. This change has little effect on the retirement fund but makes the risk fund less viable – as is shown in Figure 6.15.

Figure 6.15 The effect of heavier mortality and disability



6.6.5 Administration costs

In the base projections, it is assumed that administration costs stand at 2% of total contributions, 4% of risk benefit payments and R300 (inflating) per retirement. It is difficult to know how the actual costs might compare to these assumptions, especially in the early years as the administrative systems are developed. The effects of both doubling and halving these costs were investigated.

Doubling the costs makes the scheme as a whole unviable. Retirement fund assets are significantly less than the total value of retirement accounts after about 10 years, and the fund as a whole is nearly exhausted after 45 years, as shown in Figure 6.16. Halving the costs has a less dramatic, though still significant effect, as shown in Figure 6.17. Retirement fund assets are consistently more than the total value of retirement accounts, although the risk fund is still in decline after around 40 years.

Figure 6.16 Administration costs doubled

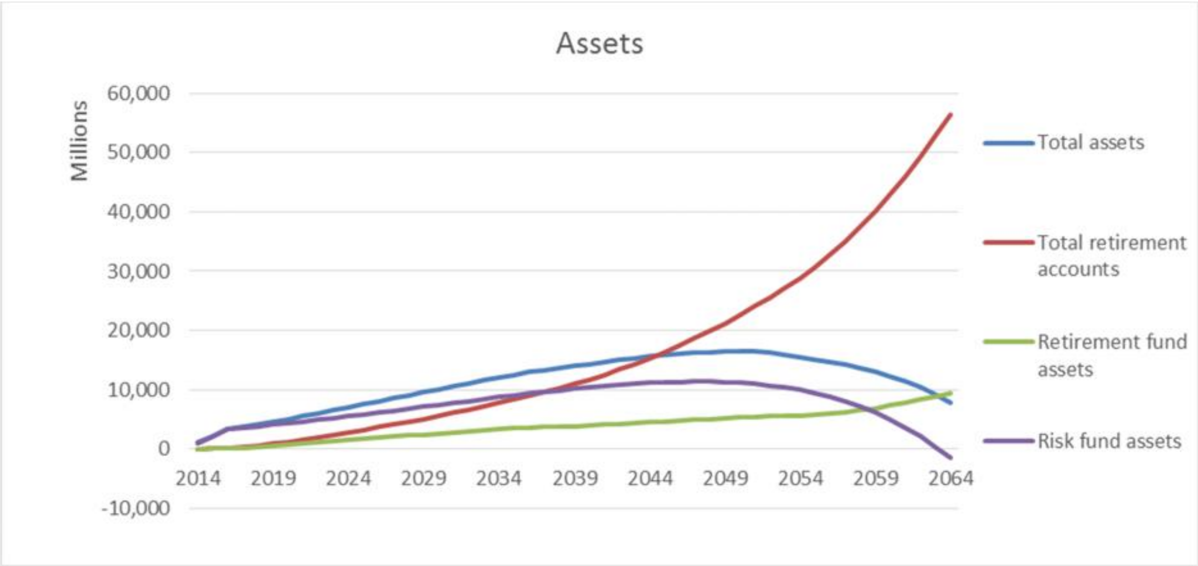
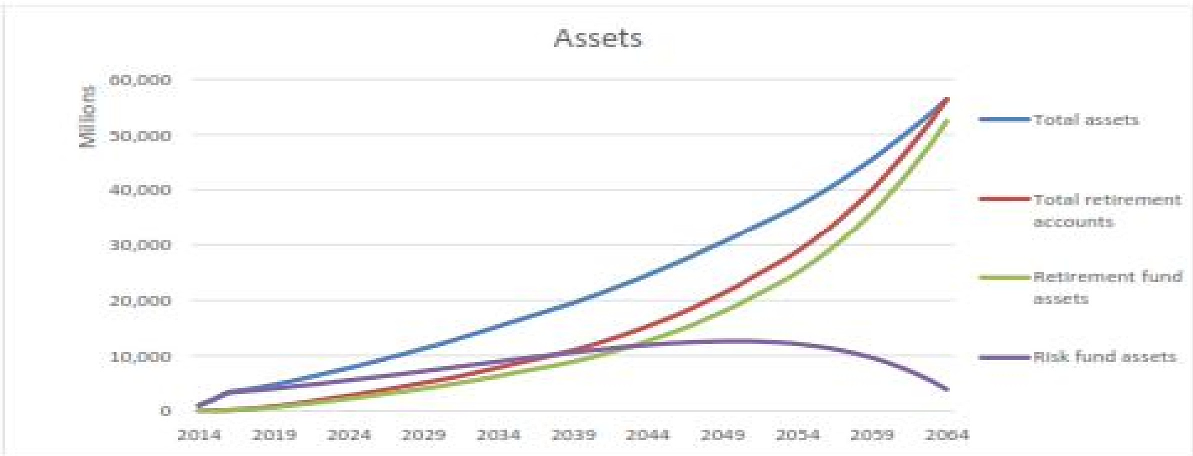


Figure 6.17 Administration costs halved



6.7 Summary

This chapter has discussed the options for benefits on retirement, death before retirement and disability. It describes four basic options for retirement benefits, as well as options for benefits on death before retirement and disability benefits, and discusses how well they meet possible criteria. It then described one option in more detail, and provided initial estimates of its cost.

Options

Four options were developed, including the current government proposals for a mandatory system (i.e. the NSSF) as one of them. The details of the government proposals are not fully specified so the version presented in this chapter may not be fully accurately although it mirrors the proposals as closely as possible. The proposals are for a DB scheme. The other three options for retirement benefits presented in the chapter are DC schemes, with varying levels of guarantees and flexibility.

Separate options were also developed, for disability benefits and benefits on death before retirement. These benefits are payable comparatively rarely compared to retirement benefits, and are generally funded through insurance or risk pooling rather than from members' individual contributions.

Recommendations

It is recommended that the fund for informal workers be a DC scheme as it would be most suitable for informal workers. A DC scheme is more able to cope with intermittent contributions and contributions of varying amounts. It is often difficult to arrive at a clearly defined monthly or annual salary for informal workers, which makes it difficult to define benefits in terms of salary levels.

There are a number of ways in which DC schemes can be varied to provide more or less certainty to scheme members. It is recommended that the scheme be such investment returns are smoothed, to lessen the investment risk borne by scheme members. The scheme would provide benefits on disability and on death before retirement defined in terms of the contributions that had been made by the member. Contribution levels will be a crucial success factor not only because higher contriibutions mean better benefits for the members but also because significantly lower contribution levels would make the scheme less viable.

A simple version of the smoothed DC option was costed, on the basis of a set of assumptions as described in chapter. While the scheme will be broadly self-sustaining over the next 40 or 50 years, this depends on the government matching members' contributions (as described in the chapter), an extra government contribution of R1 billion per annum for the first three years of operation, and administrative costs being controlled. Indeed the financial health of the scheme will depend on many factors including the level of take up.

7 Options for the administrative platform for managing the provision for retirement of informal workers

7.1 Platform components and some key issues

Key to attracting informal workers into retirement insurance arrangements is the financing and benefit design. In the current proposal for a fund for informal workers and the informal self-employed (for ease of reference referred to as the Retirement, Risk and Savings Fund or NRRSF), financing differs from that for an 'ideal' national social security system in that membership for informal workers will be voluntary,[36] contributions will be decided on by the contributor (subject to a minimum amount per month or year), and government will match contributions up to a certain level. The inclusion of risk benefits (death, disability and survivors') will be attractive. Further attention will have to be given to linking membership of the 'flexible' fund with unemployment insurance and a saving scheme for other contingencies. Informal workers could then be offered a package of an efficient savings vehicle, retirement, as well as unemployment, insurance and risk benefits.

In addition to financing and benefit design, the pension administration platform will be critical. The platform will have to be trusted by workers, will have to minimise the cost of participation to workers, and will have to minimise administrative and operational costs in order to ensure sustainability and attractive benefits (i.e. value for money) to beneficiaries. In recent focus groups assessing experiences of banks in South Africa, a participant commented that 'societies and *stokvels* is the right way because if our money goes straight to banks they end up eating our money' (FinMark Trust, 2013). Rusconi (2004), after investigating the 'level and spread' of retirement fund charges in South Africa, concluded that 'while there is a range of experience across and within savings channels, there is cause for concern overall regarding these charges'. In order for retirement provision for informal workers to take off, the relevant platform will have to buck South African trends with regard to retirement fund costs and offer investors better value for money.

Given the DC nature of the proposed fund, individual accounts will have to be maintained – which increases costs. It must also be assumed that potential contributors will not have identifiable employers (either being self-employed or being informal). This means that it will be more difficult to follow beneficiaries (also because of potentially less formal addresses) and that there will not be fairly formal accounting systems that can be relied upon. All this will make the administrative platform key.

The absence of an employer is a very significant constraint. The only private sector plans in South Africa targeted specifically at informal workers (e.g. Absa Provident Fund – Umbrella Funds for the Agricultural, Domestic Worker) do not allow individual contributors as in their experience this would increase administrative cost and obstacles (Interview notes). While in the performing arts sector, SAMRO taps the royalty stream to provide retirement contributions for musicians it is not clear that there are many other industries where one organisation is in a position to offer such clear-cut oversight of a potential funding

36 There is evidence that mandatory funds for the self-employed and types of informal workers do lead to higher coverage. However, even with mandatory schemes coverage generally remain below 30% for the self-employed. ISSA (2012) reports that in Latin America with voluntary systems for domestic workers, coverage is generally less than 5% and in mandatory systems coverage ranges between 20 and 30%; pension coverage where it is mandatory covers between 20 and 30% of the self-employed but in voluntary systems less than 5%.In the mid-1990s it was reported that less than 500,000 of 'several millions' of domestic workers in the US were registered in terms of mandatory social security legislation. It is unsound to introduce a mandate that would in effect criminalise the bulk of self-employed and informal workers (it will absorb large enforcement costs and will be unfair to those who comply). Value for money and positive incentives will be the only satisfactory way of proceeding.

stream. Currently, there are also no examples of organisations of low-income or informal workers who have the administrative systems needed to support the administration of social security registrations, contributions and benefits.

A range of administrative and governance functions can be identified for retirement funds (see, for example, Bloom and Mackinnon, 2013; Robino et al., 2012; Sluchynsky, 2008). These are 'the basic tools to support the core business processes' of a fund (Robalino et al., 2012). Table 7.1 provides a list of 12 functions as well as a range of parties/institutions that could fulfil these services.

Governance is also included in the list. Bloom and Mackinnon (2013) distinguish between 'national' governance – oversight by a designated authority, also to coordinate with other relevant national bodies and to promote transparency and dialogue – and governance 'at the level of the administering body'. The latter 'relate to a broad set of responsibilities including: (i) ensuring the pension system's long-term sustainability; (ii) defining the investment strategy for the investment of pension funds; (iii) guaranteeing oversight of the investment strategy; (iv) maintaining accurate and up-to-date individual records of the acquired rights of, and benefits due to, all scheme members; and (v) the competent and strategic management of the pension administration's human resources, ICT infrastructure, and capital investment.'

Table 7.1 NRRSF – Administrative and governance responsibility checklist

ADMINISTRATIVE FUNCTION	POTENTIAL RESPONSIBILITY					
Fund governance and procurement	Sponsor	Scheme	Administrator	Agents	Regulator	Voluntary orgs & assoc
Regulatory oversight	Sponsor	Scheme	Administrator	Agents	Regulator	Voluntary orgs & assoc
Marketing, outreach and communication	Sponsor	Scheme	Administrator	Agents	Regulator	Voluntary orgs & assoc
Customer services and enrolment	Sponsor	Scheme	Administrator	Agents	Regulator	Voluntary orgs & assoc
Contribution collection	Sponsor	Scheme	Administrator	Agents	Regulator	Voluntary orgs & assoc
Recordkeeping/registry	Sponsor	Scheme	Administrator	Agents	Regulator	Voluntary orgs & assoc
Fund and investment management	Sponsor	Scheme	Administrator	Agents	Regulator	Voluntary orgs & assoc
Claim receipt and benefit calculation	Sponsor	Scheme	Administrator	Agents	Regulator	Voluntary orgs & assoc
Review and appeal	Sponsor	Scheme	Administrator	Agents	Regulator	Voluntary orgs & assoc
Benefit payment	Sponsor	Scheme	Administrator	Agents	Regulator	Voluntary orgs & assoc
Monitoring	Sponsor	Scheme	Administrator	Agents	Regulator	Voluntary orgs & assoc
Annuity provider	Sponsor	Scheme	Administrator	Agents	Regulator	Voluntary orgs & assoc

Source: Authors' compilation from various sources (see, for example, Bloom and Mackinnon, 2013; Robino et al., 2012; Sluchynsky, 2008)

Key questions that have to be resolved about the platform (or how the core functions will be executed) are whether:

- A number of smaller funds or organisations will be required or whether one large fund should be aimed for;
- A public entity (with some autonomy) will be most efficient (such as the South African UIF, the SASSA or the Government Employee Pension Fund) or whether the operation can take the form of a Board of Trustees with a small supporting executive basically awarding and managing contracts with a range of private or public service providers (the South African Government Employee Medical Scheme (GEMS) is an example of this approach).

Robalino et al. (2012) have also pointed out that 'while a platform could initially focus on only one programme or scheme, a new administrative system should be built with a long term vision that plans for their extension to other programmes'. This also raises the question whether the NRRSF will require a new organisation or whether it can be integrated in an appropriate government institution. The UIF, for example, provide services that will be fairly similar to the NRRSF (collection of benefits, fund management, benefit payment, etc.) and there will be a potential overlap in members between the UIF and the NRRSF, for example domestic and agricultural workers who are already affiliated with the UIF. The SASSA, on the other hand, also has an extensive network of branches and benefit payment options and, in contrast to the UIF, does not collect contributions but serves quite intensively a very vulnerable group of South Africans.

7.2 Some examples of delivery platforms providing social protection benefits to informal workers

Both in South Africa and elsewhere there are some examples of pension or provident funds providing benefits to categories of unemployed workers. These display a range of governance and administrative structure and can provide pointers to an appropriate structure for South Africa. Unfortunately, in most instances, while we have broad descriptions of the schemes there is very little information in terms of costs, efficiency and value for money in the funds.

7.2.1 South Africa

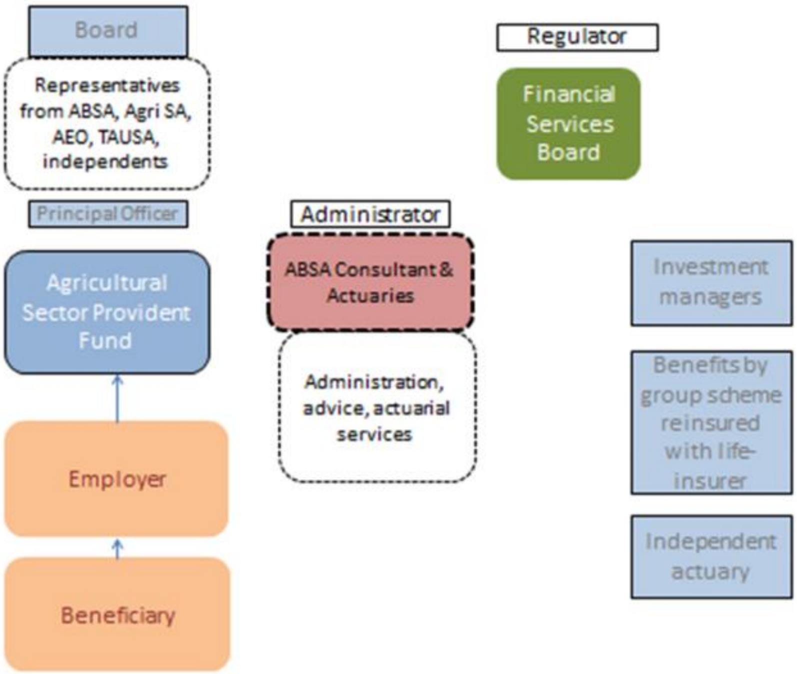
7.2.1.1 South Africa (Private)

In South Africa there is one of example of private sector funds targeting sectors that include a large number of informal workers. Absa provides provident/umbrella funds for agricultural workers, domestic workers (home employees) and small business owners and their employees. These are privately administered funds established in terms of the Pension Funds Act.

A range of plans are available to workers. Workers can only join via an employer (employer contributions are required). In the simplest plan, a monthly contribution minus costs buys a contribution to a fund with the accumulated value being available on retirement. In 2013, in the most basic plan, a contribution of R97.70 extracted a cost of R16.71 (17.1%) with the remaining R80.99 being invested. Presumably, fund management cost would be netted from investment returns. The most extensive plan, for a contribution of R255.51, would purchase death and disability cover (a capital amount of R18,036), a funeral benefit for the household (ranging from R10,000 to R2,500) and a retirement contribution of R139.91. Total costs (both for administration and insured benefits) absorb 45% of the contribution, again assuming that fund management costs will be netted off from investment returns. In 2012 the fund had just over 37,000 members and was valued at R75 million.

This is, then, an example of purely private provision in terms of the pensions and provident fund legislation. Unfortunately, with the information available, value for money cannot be assessed although it is clear that costs absorb a very large part of contributions (17% for the cheapest fund, not including fund management costs).

Figure 7.1 Governance and administration: Absa Agricultural Sector Provident Fund

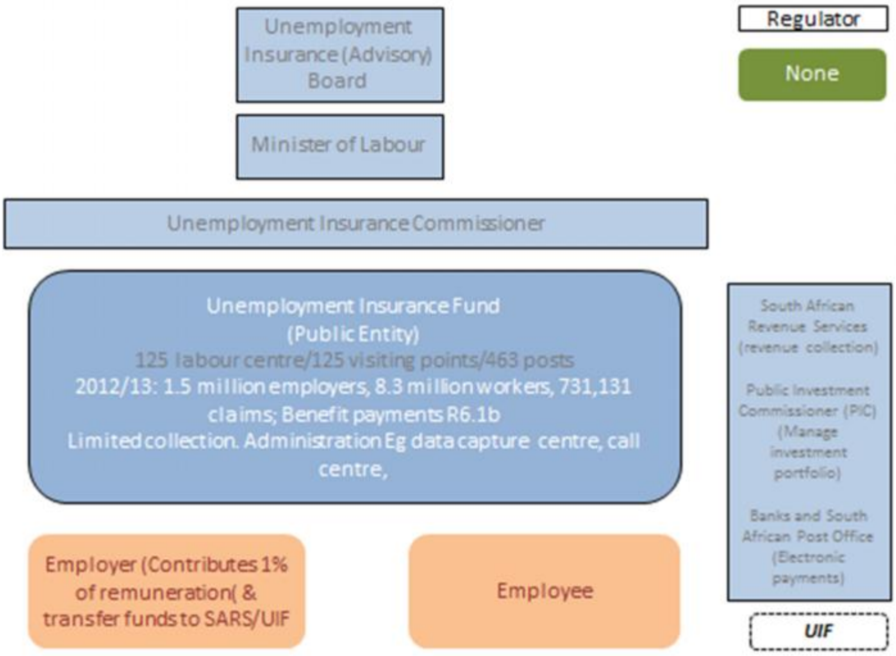


Source: Drawn for Absa, Agricultural Sector provident Fund Employer and Employee Guide www.lwo.co.za/LWO_ASPF_Employer__Employee_Guide.pdf

7.2.1.2 South Africa (Public)

The UIF is an example of a social protection scheme in South Africa that is public and close to an integrated social protection bureaucracy. The UIF is established in terms of the Unemployment Insurance Act but is a public entity in terms of the Public Finance Management Act.

Figure 7.2 Governance and adminitration: UIF

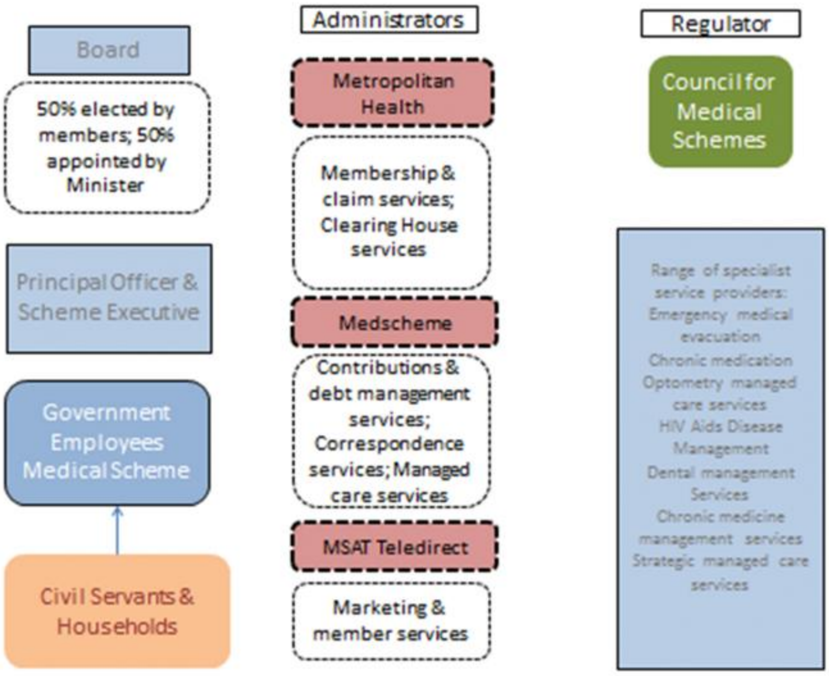


The UIF has an advisory board and is therefore under the direct management of the Minister of Labour. Even though it is a public entity, a significant part of revenue collection is outsourced to the SARS, investments are handled by the PIC, and payments take place through the banking system. It is therefore an interesting example of partnerships between government and private entities.

The UIF has been very successful in enrolling domestic workers (via their employers) but has been less successful in the taxi industry and the agricultural sector. The success with domestic workers, (with a significant number of claims from domestic workers as well) came from a strategic approach focusing on employers, clearly targeted marketing, adjustment of conditions and putting in place good, web-based registration and payment procedures. Too little information is, however, available to assess its efficiency, value for money and impact.

The GEMS provides a different set of governance and administrative arrangements in a scheme aimed at civil servants and not the broader labour force. It has a much stronger and independent board than that of the UIF, and most of its operations are outsourced to private sector providers.

Figure 7.3 GEMS



Sources: GEMS website and annual reports; Council for Medical Schemes Annual Report (2012)

At the end of 2102, GEMS had 662,469 principal members and more than 1.8 million beneficiaries. Twenty-three percent of members earned less than R7,000 per month in 2012. In 2012 it received R21 billon form members and paid R19.7 billion in healthcare expenditure. Administration costs came to R887 million or 4.2% of net contributions.

GEMS's operational structure consists of a Board of Trustees that directs the scheme's activities, a principal officer (CEO) who implements the directives of the board, and a scheme executive that supports the principal officer in monitoring and managing the service levels and contractual obligations of outsourced services.

The independent Board of Trustees is responsible for providing the scheme's strategic direction, overseeing the implementation of the strategic plan by management, and overseeing the management of risk. The Board of Trustees is comprised of 12 persons who are deemed fit and proper to be trustees. 50% of the trustees are elected by members by means of a postal ballot process, while 50% are appointed by the Minister for Public Service and Administration.

The scheme’s head office staff complement in 2012 consisted of 47 positions, of which 43 were filled. In addition, a pilot Client Liaison Business (CLO) unit comprising 41 contract posts assisted members with queries related to GEMS business.

There are six committees of the board that oversee the work done in various areas: the Audit Committee; the Operations Committee; the Ex Gratia Committee; the Governance and Risk Committee; the Dispute Committee; and the Remuneration Committee.

GEMS contract with a network of service providers for administrative and operational services:

- Europ Assistance – Emergency Medical Evacuation Dispatch
- Medipost Pharmacy – Chronic Medicine Courier Pharmacy
- **Medscheme – Contributions and debt management services; Correspondence services**
- Medscheme Health Risk Solutions – Managed care services
- **Metropolitan Health – Membership and claims services**
- **Metropolitan Health Risk Management – Clearing house services**
- MSAT Teledirect: Marketing and member services
- Opticlear – Optometry managed care services
- Prime Cure – HIV/AIDS disease management services, Dental management services
- Universal Healthcare Services – Chronic medicine management services; Strategic managed care services.

7.2.2 India

7.2.2.1 India: National Pension System (NPS) Swavalamban

India's NPS Swavalamban (also known as the NPS Lite), for Indian nationals working in foreign countries, is an extension of the NPS in India. The NPS was initially established for civil servants and from May 2009 was opened to all Indians. The NPS Swavalamban was established in 2010 to 'extend the coverage of NPS to the weaker and economically disadvantaged sections of the society' and aims at building up a corpus sufficient enough to buy an annuity for their old age.' The scheme is voluntary and there are no minimum amounts per year per contribution. Key principles of the scheme include the following:

- A focus on ultra-low administration and transaction cost to make small investments viable;
- Harnessing the outreach of government schemes combined with those of NGOs, MFIs and NBFCs to target and service old age needs; and
- Using 'aggregators' responsible for enrolments, collection, reconciliation and transfer and services and information.

Government undertook to contribute INR 1,000 per year to each NPS account opened in 2010/11 and for another five years for people who have joined with a minimum contribution of INR 1,000 and a maximum contribution of INR 12,000.

Aggregators or organisations taking applications and managing the registrations of groups of potential members play a critical role. Aggregators are incentivised through a payment per registration of INR 50, a per capita incentive increasing as the number of beneficiaries subscribed increases, and support of INR 20 for promotional activity and material. Criteria for 'persistency' or accounts staying active beyond the year of opening are stipulated. Potential aggregators are identified as: (1) 'Nodal offices/entities running certain schemes for identified beneficiary groups under Central and State Governments'; (2) MFIs; (3) NBFCs; (4) NGOs; (5) Entities running common service centres under the National E-Governance Plan; and (6) Any other category as identified by the Pension Fund Regulatory and Development Authority (PFRDA) from time to time. Entities must be registered as a business organisation or charitable organisation and there are technology and capital requirements.

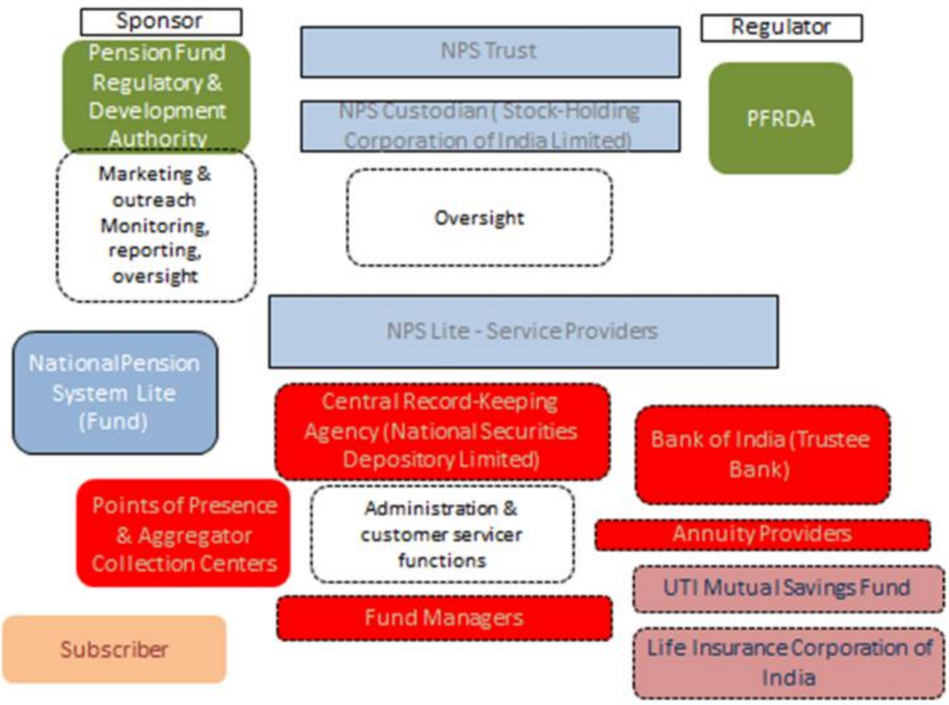
The basic institutional structure of the NPS Lite is set out in the diagram below. The key players are:

- **The PFRDA, an autonomous government agency with the mandate to develop and regulate the pension market.** It is the sponsor of the scheme and appointed the **NPS Trust and the Stockholding Corporation of India** as trustees and custodians of the scheme, respectively; and
- **Point of Presence/Collection Centres:** Subscribers can enrol, pay contributions and get information at appointed points of presence or through collection centres set up by aggregators (which also put in place accounts offices).

Other service providers to the NPS Lite Fund are:

- The **Central Recordkeeping Agency (CRA),** which is responsible for all administration and customer service functions for all subscribers of the NPS. The National Securities Depository Limited (NSDL) has been appointed as CRA. The NSDL, established in terms of the 1996 Depositories Act, is primarily responsible for recordkeeping of the ownership and transfer of securities in India;
- Six **Fund Managers** appointed by PFRDA manage retirement contributions;
- The Bank of India is the **trustee bank** to facilitate transfers across various entities of the NPS Lite system; and
- Annuity Service Providers are responsible for delivering a regular monthly pension to members after they exit the NPS Lite.

Figure 7.4 Components of the NPS Lite pension benefit system in India



Piggy-backing on the NPS Lite, the Ministry of Overseas Indian Affairs in 2013 also introduced the Pension, Life and Insurance Fund (PLIF) for Indians working overseas. In addition to the subsidised retirement saving in the NPS Lite, the scheme also offers a death benefit and subsidised savings vehicle for savings which can be accessed on return to India.

Table 7.2 PLIF for Indians working abroad: financing and benefits

Financing Annual	
Women	**Men**
Own contribution:r4,000 saving (Return and Resettlement); r1,000 pension	Own contribution:r4,000 saving (Return and Resettlement); r1,000 pension
Government contribution: r2, 000 to saving; r1, 000 pension	Government contribution: r1, 000 to saving; r1, 000 pension
Allocation of funds	
Return & Resettlement /Unit Trust of India (UTI) r4, 000; NPS lite r3, 000; r100 LIC	Return & Resettlement /Unit Trust of India (UTI) r4, 900; NPS lite r2, 000; r1000 LIC
Life Insurance	
Through Life Insurance Company of India: r30, 000 in case of natural death; r75, 000 death through accident; r37, 500 permanent partial disability due to an accident	Through Life Insurance Company of India: r30, 000 in case of natural death; r75, 000 death through accident; r37, 500 permanent partial disability due to an accident
Saving	
In UTI Mutual Fund	In UTI Mutual Fund

Note* Government contribution limited to 5 years

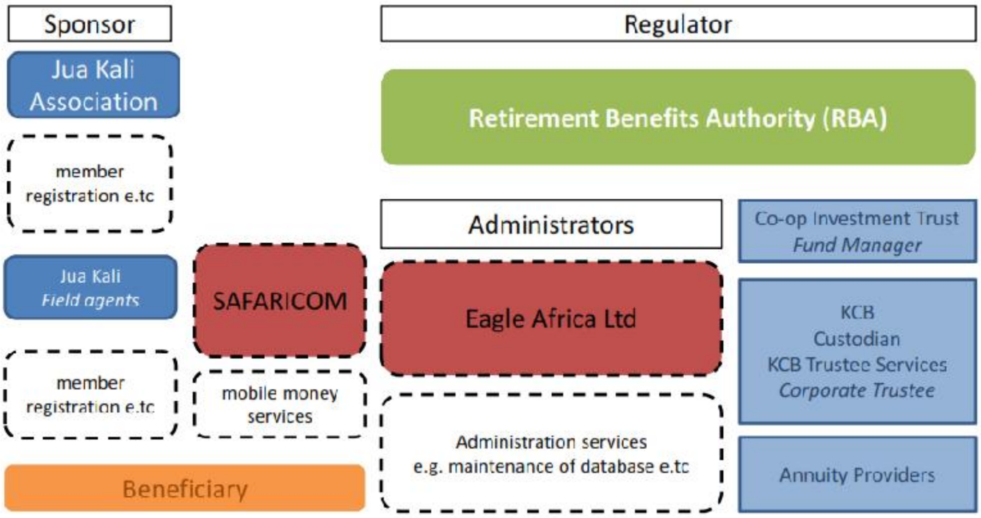
7.2.3 Kenya

7.2.3.1 The Mbao Pension Plan

The Mbao Plan is a voluntary savings programme to help people save for retirement. It is called ‘Mbao’ to refer to the KES 20 ($0.20) that represents the minimum daily contribution (there is no upper limit) that members are asked to make. Key aspects of the scheme are:

- Minimum contributions that are low and can be made flexibly – at least US$5.00 per month;
- Contributions are made only via mobile money;
- It pays lump sum benefits (equal to contributors’ accumulated assets in the fund) on retirement and death;
- There is an option to buy an annuity with the lump sum received on retirement;
- Early withdrawals can be made after contributing for two years or longer but only full withdrawals are allowed;
- Benefits are paid by cheque

Figure 7.5 Components of the Mbao Individual Retirment Benefits Scheme



The basic institutional structure of the Mbao pension scheme is illustrated in the diagram above. The main players are:

The Retirement Benefits Authority of Kenya is the sole authority charged with regulation and supervision of the pensions market. Its objectives include: the regulation and supervision of the establishment and management of retirement benefits schemes; the protection of the interests of members and sponsors of retirement benefits schemes; the promotion of the development of the retirement benefits industry; and advising the Minister for Finance on the national policy to be followed in regard to the retirement benefits industry.

The Jua Kali Co-operative Society Ltd is a national association of informal sector workers. Mbao was started by the association and its network is instrumental in the recruitment/registration of members of the scheme. Registration forms for the scheme are obtainable from Jua Kali chapter offices or from Jua Kali agents who are spread across the country.37

Safaricom, the large mobile network operator, provides its mobile money platform, M-Pesa, for the collection of contributions. In fact, contributions can only be made through M-Pesa, a very widespread mobile phone-based mechanism for transferring funds. This makes it very easy for people to pay contributions because distance from financial institutions and other payment agents is not an issue, and payments are also less costly because they do not flow through the banking system.

37 In order to register, one pays the agent the registration fee of KES 100 to get the registration form after, which the agent helps to fill in and then takes it in to the Jua-Kali chapter office (and subsequently to the administrator). The agent gets KES 50 for each registration and the balance (KES 50) is given to the Jua-Kali Association as an admin/processing fee; see www.ppftz.org/home/uploads/23rdconference/Coverage_of_Social_Security_to_Informal_Sector_Kenya_experience.pdf.

Table 7.3 Mbao Plan service fees

MBAO		NORMAL M-PESA			
Savings for Mbao (KES)	Charges to save for Mbao (KES)	Transaction amount (KES)	Charges to transfer to other M-Pesa (KES)	Charges to transfer to Unregistered users (KES)	Charges to withdraw from M-Pesa agent
0-49	3	10-49	3	N/A	N/A
50-99	5	50-100	5	N/A	10
100-999	10	101-500	27	66	27
1000 plus	15	501-2500	33	66	27

Other service providers to the Mbao Plan are:

- **Eagle Africa Ltd**, which is responsible for all administration functions for all Mbao subscribers;
- Co-op Investment Trust, who act as **Fund Managers**;
- **Kenya Commercial Bank (KCB) Trustee Services**, who act as the corporate trustee;
- **KCB**, who are the custodians; and
- **Private annuity service providers**, who are responsible for delivering a regular monthly pension to Mbao members after they exit the scheme.

7.3 Principles and recommendations

In South Africa there would probably be 2 million self-employed and informal workers who would be interested in joining a retirement fund in order to ensure consumption smoothing into old age – the other 2 million would be able to rely on the SOAP for adequate replacement rates. The decision to join would depend on adequate incentives such as a contribution subsidy or match and an administrative system that can be trusted and is cost-efficient.

It is clear from the evidence that small funds are costly – partly because of a lack of economies of scale and partly because of the absence of sufficient risk sharing in regard to risk benefits. Value for money seems to be low in markets consisting of a large number of smaller funds with little long-term preservation. ISSA (2011) has indicated that it is sometimes believed 'that a centralized, unified system for collecting social security contributions and taxes holds the potential to be more efficient. Most often, this is argued to be so because centralization is thought to bring economies of scale and help coordinate audit and record-keeping activities'. Rusconi (2004) has indicated that choice and flexibility is something people are prepared to pay for and cost is therefore only one of the factors that should influence decisions about a pension system. He points out that 'reducing charges should not be seen as the most important goal of system design'. Similarly, Whitehouse (2001:43) states that, 'Lower administrative charges can involve substantial constraints on individual choice of pension provider and of pension-fund portfolio and limits on competition. This conflicts with other goals of pension reforms and might adversely affect pension funds' net rate of return.'

From many perspectives a large national fund for informal workers seems ideal. It will economise on scarce skills and capacity to run such funds. Such a fund can also generate significant economies of scale, driving down costs and providing risk pooling. Arguably, a large fund will also allow for effective marketing and for the shifting of views on providing for retirement and other social risks. It may even promote social solidarity.

This section therefore first sets out what the architecture for a voluntary, national fund for informal workers could look like. However, given that the establishment of such a fund will be ambitious – and demand uncertain – we also ask whether there are potential intermediate steps or phases in moving to a large, efficient NRRSF.

Table 7.4 Success factors in contribution collection and compliance for retirement funds

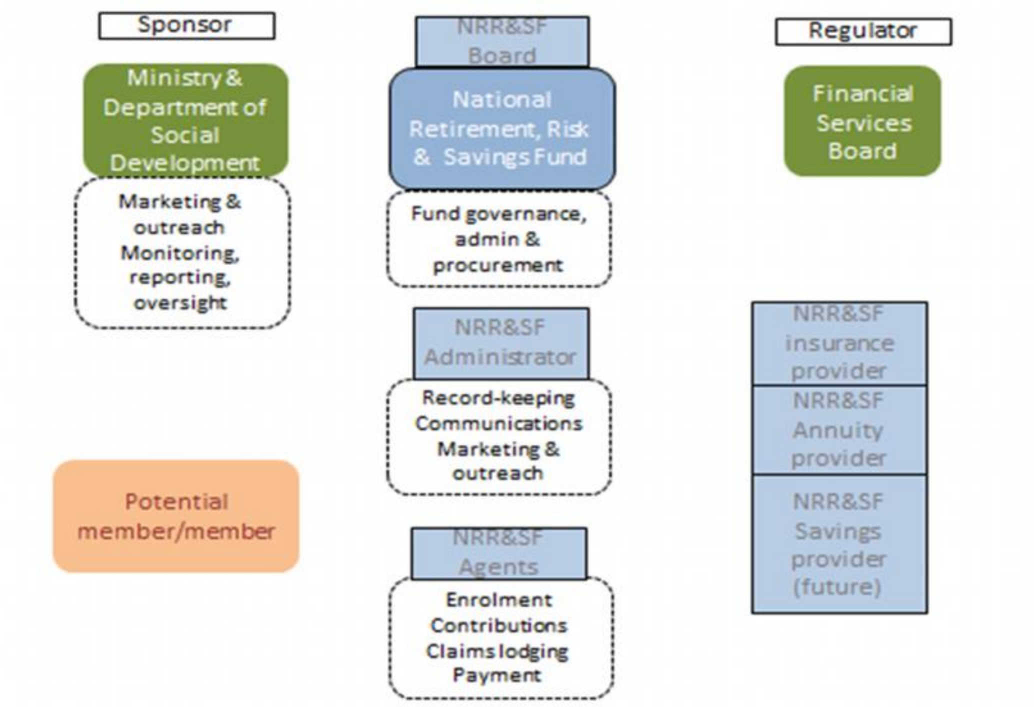
Success factors in contribution collection and compliance for retirement funds (ISSA 2011)
• The maturity of the social insurance programme.
• The degree of coverage and size and diversity of the labour force.
• The degree of automation.
• The extent of coordination with outside organisations.
• The constant evaluation and adjustment of collection policies and practices.
• The extent of a country's social security culture.
• The existence of a culture of compliance among employers and workers.
• The effectiveness of compliance enforcement measures and penalties for non-compliance.

The Figure 7.6 sets out a proposed administrative structure for an NRRSF for South Africa. While it is clear what functions have to be fulfilled, there are a range of options for potential suppliers in relation to a number of functions.

In terms of **overall (national) governance**, the sponsor will be the MOSD (or 'Ministry of Social Protection') if such a department is established in close cooperation with the Ministry of Labour. In addition to driving the establishment of the fund, the MOSD will also play a key role in initial marketing and outreach and eventually in monitoring and reporting on the performance of the fund. The fund will be established in terms of the Pensions Act and be regulated by the Financial Services Board or such other regulator as may be established.

In terms of **organisational governance**, the fund will be governed by a Board of Trustees. While government should have some say in appointing board members, in terms of the Pension Funds Act, 50% of trustees will have to be appointed by members. The board would appoint a principal officer/CEO who would establish an executive to serve as secretariat to the board, set in place core management arrangements, and build the capacity to execute functions or secure the necessary service providers.

Figure 7.6 Proposed administrative structure for a NRRSF



There are various options of fulfilling key functions in-house versus outsourcing. Given the range of specialist functions involved and limited capacity in these – as well as the potential bargaining power of the fund as a purchaser – it would be advisable for key functions to be outsourced and for the executive and board to be set up with a tight focus on monitoring and supporting provision of services by service provider. In some cases it will be possible to outsource to other public providers, but these would preferably all be accessed through competitive processes.

For example, in terms of administrators it would potentially be possible for a NRRSF to utilise the UIF or SASSA. However, there are of course many specialised private pension fund administrators. In the case of fund management, the PIC would be an option but again there are many private fund managers. In terms of securing risk benefits and annuities the fund will be dependent on the private market.

Critical decisions will also have to be made about initial enrolment. In the private industry brokers play a useful role in bringing buyers and sellers together (National Treasury, 2013) but this also raises costs. Related to this, automatic enrolment in a default fund is often proposed but this will not be an option with informal workers. It is in this context that the Indian NPS Lite is an interesting example. In addition to more conventional 'Points of Presence' (such as public and private banks) where individuals can enrol, they also incentivise 'aggregators', organisations that help to enrol larger groupings of people.

An option could be for workers' organisations such as NAFU, SAMRO, FAWU, SADSAWU, SATAWU, etc. to be used as entry points into each sector. Under such an option, these organisations can tailor the branding of the scheme for their sector, i.e. the scheme will remain a single scheme but will be branded differently for each sector. Although the present study revealed that most workers' organisations would be keen to be involved in ensuring the success of a government-supported initiative to improve retirement savings in their sectors, further thinking is needed to flesh out how these aggregators could be incentivised and monitored.

The debate on whether a singular governance structure for social protection is the way forward for South Africa has a long history, with the Taylor Report of 2002 making recommendations for the establishment of a social security agency administering both social assistance and social insurance funds. While SASSA was established in terms of the SASSA Act No. 9 of 2004, leading to it taking over the administration of social assistance in 2006, it has no responsibility for social insurance. This is despite the Act leaving room for the mandate of the agency to ‘provide for the prospective administration and payment of social security by the Agency and the provision of services related thereto.’ As shown in Annex C, a long-term goal could be to have a single governance structure where each social security institution is subject to the authority of a social security board and executive. However, given the fact the present report is just one of many steps toward the establishment of a state-supported fund for informal workers, such-national scale, multi-institutional reforms may be better debated at a later stage.

8 Conclusions and recommendations

8.1 Background

In what are now developed economies, social security systems emerged at the turn of the 19th century. These systems were formal and in general consisted of social insurance, social assistance, family allowances and national health systems. Each of these components often complemented each other, and they were meant to assist individuals during expected and unexpected contingencies (e.g. death and disability, respectively) and to provide benefits for people with children as well as assist individuals in accessing health care.

When these systems were designed, the underlying assumption was that of a society whose economy would exist at full or nearly full formal paid employment. In such a society, most individuals would have the means to contribute throughout their working lives toward social insurance programmes and the state would only need social assistance programmes cover the few who cannot provide for themselves or who need additional support.

In the developing world, the assumption of a society in which there is full or nearly full formal paid employment does not hold. In many developing economies, individuals cannot contribute to a pension or any form of social insurance during their lifetime. This means that the impact of both expected and unexpected events, such as retirement, death, disability etc., can greatly affect the standard/quality of life of not only those directly affected by the event but also those that depend on these individuals for care and subsistence – in most cases children. For these individuals, there is very little income after retirement and there is very little social insurance in the case of the unexpected events discussed earlier.

In the context of inadequate retirement income coverage and low value for money from the private and occupational system, the South African government has been involved for some time in developing proposals for social security reform. This reform, among other things, explored the idea of introducing a mandatory statutory fund that provides pension, life insurance and disability benefits. The rationale for the reform is that too few South Africans save adequately for retirement. A statutory fund was proposed and its purpose is to address some of the shortcomings of the current retirement environment, including the essentially voluntary nature of the current system, the high level of withdrawals before retirement, high fund costs due to the large number of private sector funds, and low levels of annuitisation (National Treasury, 2012).

To date, this exploration for a set of broader reforms to enhance savings and retirement provision among South African workers has largely been focused on formal workers. These are workers who, for the most part, have formal contracts, regular pay and are represented by a professional body or other such industry organisation. However, as research shows, South Africa has a significant number of informal workers who are vulnerable because of lack of access to social protection. The generally receive lower wages than formal workers and have little job security as well as fluctuating income. While all South African citizens have access to the SOAP, there is a large number of workers whose incomes before retirement are higher than that the SOAP will provide upon retirement, meaning that, for these workers, the earnings replacement the SOAP provides will be too low.

Realising that the latest social security reforms in South Africa, which include the SOAP and the UIF, have not specifically addressed the relevance or appropriateness of the reforms to informal workers, the DSD commissioned this study on the inclusion of informal workers in the reform of retirement provision.

8.2 Types of social protection schemes

Chapter 2 highlights that the main kinds of social protection that can be used to extend social protection to informal workers are social assistance programmes, social insurance systems, occupational schemes and individual-level insurance schemes.

It is apparent that social assistance programmes can achieve a high level of coverage in terms of basic income protection. They offer a minimum level of protection for the most vulnerable members of society, including many of those working in the informal economy. However, they are not targeted specifically at informal economy workers and may even exclude many informal workers if they are means-tested. Their reliance on funding from tax revenues means that they can come at a high fiscal cost, particularly in countries with large informal economies. At best, they can offer an initial tier of social protection for some workers operating in the informal economy. However, in isolation they are inadequate as they do not offer the levels of protection required by higher-income informal workers.

Social insurance systems on the other hand can be successful in including informal workers, but much of their success depends on the design of the system. Mandatory participation has seen only limited success in extending coverage, while voluntary incentivised participation appears to offer more potential. The key determinant of successful expansion is the creation of a scheme adjusted to the needs and circumstances of those operating in the informal economy. Successful systems have been flexible in relation to contributions (both in terms of the amount paid in and when the contributions are expected to be made), have allowed withdrawals under special circumstances, have offered subsidisation of contributions, and have packaged a number of benefits into one system. They have also ensured that the system is as accessible as possible for those in the informal economy, often by using existing infrastructure (including existing grant systems) or by increasing access to bank accounts, and have provided education on pension systems as well as information on specific schemes.

Occupational schemes have achieved some level of success in a few countries and offer some potential for expansion. Most notable has been the experience of welfare funds in India. The major advantage of welfare funds lies in the way in which they reduce the financial costs associated with the provision of social protection for both the government and for individuals by financing benefits out of dedicated taxes levied on the industry or occupational group. However, there are limits to the number of welfare funds that can be created and some occupational groups may be impossible to cover with this type of a scheme. Agriculture workers are frequently covered by entirely separate schemes in both developed and developing countries.

Individual-level insurance schemes have seen some success in extending social protection coverage in the form of micro-pensions. The successful experiences of several large MFIs offering micro-pension products have indicated the high levels of willingness by informal workers (even those at low incomes) to pay into pension systems when these systems are designed in a way that understands the needs and circumstances of informal workers (e.g. the need for flexibility in contributions). The major limitation of these schemes relates to the relatively high level of contributions that participants have to make in relation to their income levels.

Community-based schemes have shown only limited success in expansion of coverage and, even then, this has only been in the area of health care. These schemes have relied heavily on donor funding and tend to offer limited benefits. They might, however, have the potential to act as a platform from which to expand coverage in national social insurance systems in some circumstances.

8.3 Understanding informality and the characteristics of informal work in South Africa

Chapter 3 provides a literature review on the concepts of informality and how it has evolved over time. The chapter highlights some key aspects of the understanding of informal work, especially in the context of extending social protection. Some of the key findings of this chapter are the following:

- People enter informal employment *for different reasons* – it may because of a lack of access to formal opportunities or it may be to avoid regulations that make running a business too costly or difficult.
- Informal employment involves a *wide range of activities* (trading, manufacturing, services, etc.) and can be *found in most industries* (agriculture, construction, finance, etc.).
- Informal employment involves activities with *wide variation in terms of their economic potential* – some activities are marginal and unlikely to provide much more than basic survival for individuals involved in them, others are more dynamic and efficient with a greater potential for growth, and others involve large, technologically sophisticated firms making use of informalised labour.
- Formality and informality are better viewed as *operating on a continuum* – employment can be more or less 'formal' depending on how regulated and secure the employment is.
- *Informal activities interact with formal activities* in a variety of ways – there are numerous backward and forward linkages to each other and sometimes the same individual is employed simultaneously in a formal and in an informal job.
- Despite the heterogeneity of the sector, there is one characteristic that all forms of informal employment have in common – the lack of formal mechanisms of social protection inherent to these forms of employment and the concomitant inherent insecurity that this implies for the individual. This is the common denominator underlying informality in employment and is of major significance for the purposes of this study.

Following these key aspects of the informal being highlighted, Chapter 3 explored the characteristics of informal work in South Africa. It was noted that estimating the number of informal workers is always challenging, due to data availability issues that are compounded by the sometimes-unregulated nature of informal work.

The number of informal workers in South Africa is estimated at 3.8 million individuals (according to the worker-based definition and including agricultural workers) in a wide range of occupations. In South Africa, informal work remains smaller than what is seen in other southern African countries and sub-Saharan African countries. Excluding non-agricultural employment, current data suggests that informal employment as a percentage of total employment is around 33% in South Africa, compared to estimates of between 25% and 65% for Africa as a whole. However, there are many indications that the number of people in informal work is growing in the country. Finally, while the survey data does not show growth in informal employment over time, there is evidence from sector-specific studies that indicates a trend of increasing casualisation and externalisation of labour in the construction, clothing and agricultural sectors.

Some of the underlying characteristics of informal work in South Africa are that incomes in the sector are largely low and intermittent. According to the latest LMDS survey data (2012), a cumulative total of about 52% of informal workers earn R3,500 or less every month. Of these, nearly 57% earn more than R1,270 a month, the value of the SOAP in 2012. Because of this, earnings replacement once retired, in the absence of any other retirement provision scheme, is low.

While informal worker earnings vary greatly by type of informal worker, by employment category and by gender, household survey data suggests that those informal workers that are self-employed (and sometimes employ other workers) earn more than those that work for someone for a wage. Generally, those in private households and agricultural sectors earn the least, while those in NGOs and some state-owned enterprises earn more. By gender, men in informal work earn more than women, on average.

In sum, South Africa has a large and growing number containing a diverse range of people in informal employment, all of whom have limited social protection (as shown by the synthesis of the KIIs and FGDs presented in Chapter 5).

8.4 Lessons from abroad as well as from the UIF in South Africa

Chapter 4 presents a number of case studies of social protection reform from a number of countries that have managed to institute social reform successfully. The chapter looks at five case studies from Chile, Tunisia, Kenya, Brazil and South Africa. For each of the other countries but South Africa, a summarised synopsis of the kind of social protection plan is presented, together with the main challenges and/or achievements. For South Africa, a more detailed description and analysis of the local UIF implementation and extension is provided.

Extending social protection to informal workers is fraught with challenges, some to do with the demand side of the extension (the workers) and perhaps many more to do with the supply side (the kind of protection offered). In cases where the scheme meets the needs of those targeted, given adequate information on and awareness of the scheme, levels of contribution to social protection increase. In Chile, for example, many years of offering schemes to vulnerable workers have resulted in the country boasting of one of the highest rates of informal worker coverage.

There is a real need to create bespoke, innovative solutions that are specific to the country in question and the nature of the informal workers targeted. In Tunisia, challenges in extending social protection required in-depth knowledge of the levels of earnings among informal workers, while in

Kenya the use of mobile phone technology made it possible to extend social protection to informal workers. In South Africa, the UIF is a working example of how extending social protection to those that have vulnerable employment can work. In the 2012/13 fiscal year, the scheme had over 700,000 beneficiaries, underscoring the reach it has had in the South African labour market. Despite the many challenges then, social protection can be extended successfully to informal workers and there are a number of examples from around the world that highlight the potential benefits of doing so.

8.5 What informal workers think about the proposal to extend retirement provision

Research that was conducted shows that, as expected, there is a huge variability in earnings across the industries. Some workers receive regular incomes (e.g. those in the transport sector) while others (such as artists) experience more erratic incomes. This shows that there is definitely a need for a pension system among informal workers but that designing an appropriate contributory system will be challenging as earnings are markedly different.

Representatives of the 14 organisations interviewed not only expressed interest on behalf of their members but also felt that it was a necessity. It would appear then that there is a significant market for the scheme. However, actual uptake will depend on the scheme’s flexibility in presenting retirement solutions for informal workers, the risk benefits included (as nearly all of the organisations we interviewed have some sort of risk benefit scheme for their members), and the extent of government subsidisation.

The scheme would have to be flexible enough to meet the needs of the different sectors, while remaining simple and straightforward enough for beneficiaries to trust it. Many organisations informed us that they would like to support their members, especially in terms of advocacy and communication. Some organisations would find this easier than others, so sector-specific approaches may be needed to ensure that, across all sectors, adequate information about the scheme reaches the target audience.

Chapter 5 also presented FGDs that were conducted with a limited selection of informal workers. Some of the key lessons that came out of these discussions were as follows:

Willingness and ability to pay: There was a high level of willingness to participate in a contributory pension system. More importantly, participants also felt that most informal workers would have the ability to do so as long as the expected contributions were not too high.

Risk benefits: The death and disability benefits were met with great enthusiasm. The death benefit in particular addresses a key concern that came up early in all FGDs (i.e. what would happen to the contributions and whether their dependents would benefit from these contributions in the event of their death). Participants seemed to display a preference for monthly payments instead of an initial lump sum in the event of death.

Minimum monthly contributions and options for top-ups: Many suggested that if one chooses to participate in the system, one should pay a mandatory minimum but have the option to contribute more. There was great resistance to the idea of basing payment on incomes earned. However, their responses seemed to suggest that the way in which they would pay in would effectively constitute the same thing (i.e. in months of higher income, they would pay in a greater amount). However, it is important that the contributions never explicitly be stated as a set percentage of income, as this is likely to be a disincentive for participation due to taxation-related fears.

Flexibility in contributions: Due to the fluctuations they experience in their income, participants underscored the need for flexibility in the system. Most importantly, they felt they needed flexibility in terms of the contribution amount they would be expected to pay each month. Some participants suggested that there should also be flexibility in *when* they could pay into the system.

Greater contributions to translate into greater benefits (transparency in contributions and benefits): Participants felt that higher levels of contributions needed to translate into higher levels of benefits in order to encourage workers to pay more into the system and to make the system fair. It is important that there is transparency and readily available information as to what level of benefits the contributions translate into.

Information and education to encourage participation instead of mandatory participation: It was felt that informal workers should be encouraged to participate in the system through the provision of education and information on the system and its benefits rather than being forced into the system. Appropriate levels of information and accessibility to the system would be likely to yield high levels of participation, as the system addresses the current savings and insurance gap faced by informal workers.

Preservation of savings is important in the event of non-payment: Participants expressed a need for preservation of their accumulated savings in the event of non-payment, as this has been a disincentive for informal workers to enter into formal insurance schemes in the private sector in the past. They expressed a need for grace periods during months in which they were unable to make contributions.

Suggested additional benefits: medical cover, education withdrawals, loan facilities, funeral benefits and unemployment benefit: Participants expressed a need for additional benefits to be included in the system. Some of these may be better addressed outside of the retirement system (e.g. access to credit, medical cover), but others could potentially become part of the retirement system design (e.g. unemployment benefits and withdrawals allowed for education expenditure).

Administration through central government and not municipal authorities: Informal workers have a high level of distrust in municipal authorities and would only be willing to participate in the system if it was administered by central government.

To reduce fraud, the system needs to be clearly identifiable as a legitimate government initiative and easily recognisable: Participants felt that in addition to clear communication, there was a need for a clear logo and information on how to pay into the system to ensure that opportunistic individuals could not take advantage.

Harmonisation of government policies and systems: Government policy pertaining to informal workers needs to be consistent. Protecting informal workers' access to income-earning activities is of utmost importance if informal workers are to be able to pay into the system. Their activities need to be supported, particularly at the municipal level where they currently experience considerable harassment. Current government systems could also be harmonised so that workers have the option of paying into the system from grants.

Consultation with informal workers on the design and implementation of the 'new pension': Participants made it clear that, in order for the mechanism to be accepted by informal workers, the government would have to consult more extensively with them on the design and implementation of the proposed mechanism, through their leaders or representatives. Participants also stressed the importance of consulting not only with young leaders but also with older leaders who may have more knowledge of the context and more long-term understanding of the needs and challenges faced by informal workers.

The FGDs suggest that informal workers are certainly willing to pay into a contributory retirement system as such a system addresses a current gap in savings and the insurance available to those in the informal economy. The challenge is to ensure that informal workers are adequately informed and that the system is designed in a flexible way that ensures workers have the ability to pay into the system.

The FGDs thus showed that, in order for the proposed mechanism to work and be accepted by informal workers, it should be transparent. It is essential that there is an understanding that the proposed mechanism is not designed to replace the existing social protection mechanisms in place such as the SOAP. There needs to be clarity on the protection of contributions that participants make, even in the event that they are no longer able to pay in their contributions to the mechanism.

One of the key challenges is in asserting that the mechanism is designed primarily as a retirement provision mechanism and that, although the government is cognisant of the numerous challenges that informal workers face in accessing financial and other services, this mechanism cannot address all those challenges nor provide the associated services or benefits. Finally, there may be a need for the creation of a body that facilitates consultation between the government and informal workers to ensure that the proposed mechanism is acceptable and relevant to informal workers, both in terms of design and implementation.

8.6 The NRRSF for informal workers

This study presents four benefit options. Chapter 6 provides an in-depth analysis of these benefit options using many criteria including attractiveness (e.g. lump sum benefits versus annuities) and predictability (for example, by defining in advance both the amount and timing of benefit payments). Other criteria include the potential impact on social welfare (e.g. inequality), flexibility (to be varied at the option of the member, or depending on their particular circumstances) and ease of communication (simple and attractive benefits are often easier to communicate).

At any rate, there will always be risks inherent in schemes – primarily that the contributions will not be sufficient to pay for the promised benefits. For instance, these risks can be in the form of poor investment performance or members having higher levels of disability or longer life spans than expected. Fundamentally, an important element of scheme design is how the various risks are shared between the members, employers, scheme and government.

While it is generally the case that benefits that are more generous will be attractive to members, they are also likely to be more costly. When designing benefits, it is important to look at how the cost is split between the parties – typically employees, employers and government. The aim should also be to design benefits that are appropriate. For example, a generous and costly pension might not be appropriate for poor people with limited resources who may have low life expectancy. While a pension will reduce the financial risks of longevity for the beneficiary, lower-income members might well place a higher priority on being able to meet their immediate needs. This was echoed by informal workers who took part in the FGDs presented in Chapter 5.

8.6.1 Smoothed DC scheme

Based on the detailed analysis of the four different benefit options as presented in Chapter 6, a DC scheme would be most suitable for informal workers. A DC scheme is more able to cope with intermittent contributions and with contributions of varying amounts. Previous chapters revealed the inconsistent nature of informal workers' earnings (both in terms of timing and levels), which make it difficult to define benefits in terms of salary levels.

The smoothed DC scheme combines the flexibility and simplicity of a DC scheme with some guaranteed elements, which mean that the government, or the scheme as a whole, shares some of the individual members' risk.

Instead of being based directly on the actual investment returns, the scheme will guarantee that the rate of return will never be negative, so the amount of an individual retirement account can never decrease. However, if the actual rate of return is positive, only a fixed proportion (e.g. 75%) of it will be credited to the retirement account.

At retirement, the member must use at least 75% (or another fixed proportion) of the value of the account to buy an annuity, and may take the remainder as a lump sum. The terms on which the retirement account is converted into an annuity will be guaranteed, and only limited annuity options will be offered. It is also recommended that the pension increases with inflation during retirement, and that it be guaranteed for five years. In addition, a survivors' pension of 25% will be paid on death in retirement.

The advantage of having smoothed investment returns is that this allows predictability to the members, as do the guaranteed annuity returns. However, the requirement to buy an annuity, and the limited range of options, limit the flexibility. Explaining some of the features of the scheme – particularly the investment smoothing – might be a bit challenging. There is a slight risk of insolvency if actual investment returns are consistently poor, or if the guaranteed annuity terms are too advantageous to the members.

8.6.1.1 An illustration of the recommended option

Mr Ndebele

Mr Ndebele, a 45 year-old male from Mpumalanga, has recently started a job as a general hand at a block of apartments in Pretoria. He earns an annual salary of R24,000[38] and is willing to contribute 5% of his monthly salary to the new retirement fund.

Box 8.1 Example of a male, aged 45, salary R24,000, DC contributions at 5% of salary

Mr Ndebele's employer informs him that he will have the following benefits;

- His salary is to be increased by an average of inflation + 1% every year
- No pension
- No medical aid
- 21 days' paid leave

Mr Ndebele's employer has also informed him that he will have to retire when he turns 65. Naturally, Mr Ndebele is worried about how he will survive only on the SOAP (currently at R1,260) when he is forced to retire and has to return to Mpumalanga.

In Mpumalanga, Mr Ndebele has a wife and three children who are all still in primary school. His current salary is hardly enough for him to meet all his family's needs and although he would have wanted to save for retirement, at present, he has more pressing concerns such as:

- Ensuring he makes his funeral society contributions (R100 per month for R10,000 cover). This covers him, his wife and children so that if any of them were to pass away, funeral expenses would be taken care of. Even then, he still worries about how his family would survive if he were to die as he is currently their sole source of financial support.
- What will happen to him and his family if he were to be involved in an unfortunate accident that leaves him disabled?
- What would happen to him and his family if he were to become unemployed? He has currently started putting aside R210 per month into a savings *stokvel* with 26 other members that promises a lump sum payment of R5,670 every year. This he intends to put in his bank account as an emergency fund in case he loses his job and needs income support as he looks for another.
- Ensuring his children have all they need for school, including adequate uniforms and money for extra curricula activities. He is also worried about where to get money in cases of medical emergencies and he hopes the *stokvel* payouts will help with this.

38 According to the latest Sectorial Determinations, the minimum wage for: 1). **Domestic workers** who work more than 27 ordinary hours per week is **R1,877 per month** (1 Dec 2013 to 30 Nov 2014); 2). **Taxi drivers** – **R2,643.47 per month** (1 Jul 2013 to 30 Jun 2014); and 3). **Farm workers** – **R2,274.82 per month.** However, many informal workers have inconsistent incomes in terms of both timing and level.

Using Mr Ndebele's case, the retirement benefits provided by the different options in terms of replacement ratios and value of benefits can be compared. However, any comparisons between option 1 and the other options must be treated cautiously. While the replacement ratio for option 1 is defined in the formulae and hence guaranteed, that of the other options is a projection based on assumptions, so in reality could be higher or lower than the value. These comparisons are still useful as replacement ratios are a widely accepted measure of benefit quality, but the difficulties of calculating them for the DC options mean that there is a significant confidence interval and thus risk management will be of the essence.

The comparisons indicate the trade-offs between the DC options: the options that have less risk for the members also provide lower returns. The modelling illustrates that the SOAP is a significant source of retirement income for those on this income level. Without the SOAP (therefore only including the contributory pension) the replacement ratio ranges between 9% and 26% depending on the size of the lumps sum taken; with it the ratio ranges between 64% and 81%. For options 2 and 3 (smoothed DC and DC pension) the option of taking some of the retirement account as a lump sum reduces the replacement ratio by less than 10 points.

Options 3 and 4 (DC pension and DC retirement bonus) give higher pensions than option 2 (Smoothed DC) for two reasons: the smoothing gives a lower overall rate of return, and option 2 requires the purchase of a more expensive annuity (including inflation-proofing, a five-year guarantee and a survivors' pension). The retirement account accumulates to the same value under options 3 and 4, so the maximum pension is the same. The smoothing in option 2 lowers the investment risk to the member, and the more expensive annuity lowers the member's longevity risk.

In conclusion, a DC scheme is considered most suitable for informal workers. Such a scheme is more able to cope with intermittent contributions and with contributions of varying amounts. It is often difficult to arrive at a clearly defined monthly or annual salary for informal workers, which makes it difficult to define benefits in terms of salary levels.

There are a number of ways in which DC schemes can be varied to provide more or less certainty to scheme members. We recommend consideration of a scheme that smooths investment returns, to lessen the investment risk borne by scheme members. The scheme would provide benefits on disability and on death before retirement defined in terms of the contributions that had been made by the member.

8.6.1.2 Risk benefits

One key lesson from the consultations with both informal sector employers and workers is that a retirement fund will only be attractive if it is combined with other risk benefits. It is therefore recommended that the DC scheme with smoothed investment returns be complemented with death and disability benefits based on recent contributions.

The disability pension (as costed in this study) would provide 1.5 times the contributions made by the member in the last three years, payable until age 65, plus a contribution of 10% of each payment to the member's retirement account if disability occurs more than three years after joining the scheme. If a disability lump sum is taken instead, the member would get the value of the retirement account if disability occurs less than three years after joining the scheme.

In terms of survivors' benefits, the scheme would offer 1.5 times the contributions made by the member in the last three years, if death occurs more than three years after joining the scheme. If the member dies before retirement, the scheme would offer a lump sum of R10,000 (inflating), if death occurs more than three years after joining the scheme, or the value of the retirement account if death occurs less than three years after joining the scheme.

8.6.1.3 How much will it cost?

Using the actuarial costing tool designed for the DSD, initial costings based on the benefits described for Mr Ndebele in the previous sub-section and the risk benefits presented above were carried out.39

Some of the assumptions used in the modelling include the view that that most workers in the informal economy earn between R200 and R3,000 per month (R2,400 to R36,000 per year), and that they might contribute, say, 5% of their earnings. This would result in monthly contributions of between R10 and R150 per month. Further, the costing assumes an inflation rate of 4.5% per annum and a real investment return of 2% net of costs (i.e. a total investment return of 6.5% per annum after the costs of fund management).

The modelling also assumes that, in addition to matching members' contributions, the government makes an extra initial investment to fund the risk benefits (death and disability). This initial investment is assumed to be R1 billion a year for the first three years.

8.6.1.4 Membership profile

It terms of membership, it is assumed that a mix of members join the scheme each year and that half the members will be male and half female. While high, medium and low take-up scenarios are analysed, the primary costing assumes medium take-up, i.e. total membership of the scheme reaches around 200,000 after about 10 years and remains stable thereafter. The average contribution level is between R50 and R75 per month (with the older members contributing at higher levels).

In practice, the actual number of members who join the scheme and the level of their contributions will depend on a large number of factors, including the state of the South African economy, the growth or otherwise in informal employment, and how attractive the scheme is to workers – this number is thus essentially unknowable until the scheme is actually implemented. According to the modelling carried out, the number of retired members exceeds the number of active members after around 40 years.

39 Note that the effects of guaranteeing the annuity rates at retirement were not considered.

8.6.1.5 Scheme projections

The projections were carried out under the actuarial assumptions presented in Chapter 6, including that that the scheme is divided into two funds: the retirement fund and the risk fund. The retirement fund provides retirement benefits and is funded by 90% of total contributions (members' contributions and the matching contributions from the government). Upon retirement, the fund will pay the member the value of their retirement account. Other assumptions and detailed descriptions of the costing are presented in Chapter 6.

On the basis of these assumptions, the financial health of the scheme was projected (using a 50-year horizon). It is important to note that the assumptions on which the projections are based are founded on little data as no equivalent scheme currently exists, and the projections are therefore at best indicative. As is the case with most projection exercises, the figures for the later part of the projection period are more speculative than those for the earlier part.

The initial results, based on the medium take-up scenario described above, indicate that:

- the fund as a whole is self-supporting over the next 45 years;
- the assets in the retirement fund track the value of members' retirement accounts reasonably closely, but;
- are generally lower (i.e. the retirement fund could be said to be in deficit); and
- the assets in the risk fund start to decline after about 40 years.

As mentioned frequently throughout the report, the financial health of the scheme may be adversely affected by different membership profiles, by lower investment returns or heavier rates of mortality and disability, and by higher administration costs.

8.6.1.6 How will it be managed and administrated?

Chapter 7 notes that key to attracting informal workers into retirement insurance arrangements is the financing and benefit design. Lessons from local and international attempts at extending social protection to informal workers are that the success of such schemes also depends on the governance and administrative structure in place.

Some examples

South Africa – Private: Absa provides provident/umbrella funds for agricultural workers, domestic workers (home employees) and small business owners and their employees. Potential members can only be enrolled via their employers. These are privately administered funds established in terms of the Pension Funds Act.

South Africa – Public: (1). The UIF is an example of a social protection scheme that is public and close to an integrated social protection bureaucracy. The fund has an advisory board and is therefore under the direct management of the Minister of Labour. A significant part of revenue collection is outsourced to the SARS, investments are done by the PIC and payments take place through the banking system. It is therefore an interesting example of partnerships between various government and private entities.

South Africa – Public: (2). An interesting case is that of the GEMS, as it provides a different set of governance and administrative arrangements in a scheme aimed at civil servants and not at the broader labour force. While it has a much stronger and more independent board than that of the UIF, most of its operations are outsourced to private sector providers. The scheme's operational structure consists of a Board of Trustees that directs the Scheme's activities, a Principal Officer (CEO) who implements the directives of the Board and a scheme executive that supports the Principal Officer in monitoring and managing the service levels and contractual obligations of outsourced services. The independent Board of Trustees is responsible for providing the strategic direction, overseeing the implementation of the strategic plan by management, and overseeing the management of risk. The Board of Trustees consists of 12 persons who are deemed fit and proper to be trustees. 50% of the trustees are elected by members by means of a postal ballot process while 50% are appointed by the Minister for Public Service and Administration

India: India's Swavalamban Yohana (or NPS Lite), for Indian nationals working in foreign countries, is an extension of the Indian NPS. An especially interesting characteristic of the scheme is that it uses 'aggregators' responsible for enrolments, collection, reconciliation and transfer and services. Aggregators are incentivised through a payment per registration set-up, which increases as the number of beneficiaries subscribed increases, and support is also provided for promotional activity and materials. The sponsor of the scheme is the PFRDA, an autonomous government agency with the mandate to develop and regulate the pension market. The sponsor appointed NPS Trust and the Stockholding Corporation of India as trustees and custodians of the schemes, respectively. Aggregators set up point of presence/collections centres where subscribers can enrol, pay contributions and get information Other service providers include the CRA, which is responsible for all administration and customer service functions for all subscribers of the NPS Lite. The NSDL is another service provider and it focuses primarily on keeping records of the ownership and transfer of securities in India. There are also six independent fund managers and the Bank of India acts as a trustee bank. This means that it main role is to facilitate transfers across the various entities of the NPS Lite system. Annuities are purchased through private sector service providers.

Kenya: The Mbao Plan is a groundbreaking voluntary savings programme to help people save for retirement. The innovation is primarily because of the way in which contributions are collected. Safaricom, the leading mobile network operator, provides its mobile money platform, M-Pesa, for the collection of contributions. Contributions can only be made through M-Pesa, which makes it very easy for people to pay contributions because distance from financial institutions and other payment agents is not an issue, and payments are also less costly because they do not flow through the banking system. Another interesting element is the function of the sponsor, the Jua Kali Co-operative Society Ltd (a national association of informal workers) as an aggregator. Its primary function has been to enrol members (for a fee). The regulation of the scheme is the responsibility of the Retirement Benefits Authority of Kenya. Other service providers include Eagle Africa Ltd, which is responsible for all administrative functions for all Mbao subscribers, Co-op Investment Trust, which acts as the fund manager, and KCB, which acts as the corporate trustee and custodian. Finally, private annuity service providers are used to deliver regular monthly pensions to Mbao members after they exit the scheme.

8.6.1.7 Principles and proposed finance and administration structure

The pension administration platform will be critical to the success of the proposed fund for informal workers. The platform will have to be trusted by workers, will have to minimise the cost of participation to workers and minimise administrative and operational costs in order to ensure sustainability and attractive benefits (i.e. value for money) to beneficiaries.

Overall governance

This study recommends two options. The first is an intermediate option whereby overall governance will be the responsibility of the MOSD in close cooperation with the Ministry of Labour. In addition to driving the establishment of the fund, the MOSD should also play a key role in initial marketing and outreach and eventually in monitoring and reporting on the performance of the fund. The fund should be established in terms of the Pensions Act and regulated by the Financial Services Board or such other regulator as may be established. In regard to organisational governance, a Board of Trustees will have to be constituted.

Furthermore, it is recommended that key functions be outsourced and for the executive and the board to be set up with a tight focus on monitoring and supporting provision of services by the service provider. In some cases it will be possible to outsource this to other public providers but these would preferably all be accessed through competitive processes.

Enrolment, administration, revenue collection, fund management and payments

While it may be possible for the fund to use the UIF or SASSA as administrators, outsourcing this function to the private sector is another option. The same applies for fund management, where either specialised fund managers or the PIC are alternatives. Either way, risk benefits and annuities will be procured on the private market. To facilitate member registrations, ‘aggregators’ such as the sector-specific workers’ organisations may be incentivised and an option could be to allow them to roll the scheme out under sector-specific brands.

8.7 Overall recommendations

This study finds that most informal workers have monthly earnings in excess of the SOAP yet the nature of their work has many characteristics (e.g. variable earnings, in terms of both levels and frequency) that prevent them participating in conventional retirement schemes. As a result, many informal workers cannot maintain their standard of living, post-retirement. In terms of equity and fairness, the present situation is also unfair as higher income individuals access significant tax benefits from retirement contributions.

It is, however, also true that a contributory retirement system for informal workers is perhaps not government's most urgent priority as it deals more with (relative) benefit adequacy and not so much with poverty relief (in that it targets a group somewhat above the poorest).

A big national scheme, although desirable, would come at a great cost yet there is not yet enough evidence that take up will be high. In addition, there already are numerous examples of provident funds and other schemes that are sector specific (which necessarily means they exclude many informal workers) from which valuable lessons can be learnt.

The study make two main recommendations:

1. Because there is little systematic information on the current schemes on the market it is difficult to assess their performance and learn from their experience. As a first step, government should begin the monitoring and evaluation of existing schemes with a particular focus on establishing value for money. This type of assessment will inform decisions on how to reform and grow these specific schemes, specifically for occupational and sectoral groupings where there is more collective organisation (or an 'aggregator').

   While there are quite a number of existing schemes that are extremely interesting, the UIF stands out particularly because it is run by government. The performance of the UIF should be assessed in regard to domestic workers. Such an exercise will not only reveal important lessons but can be an opportunity for an indicator framework to be developed, for use in the assessment of other schemes such as the SAMRO and Absa funds.

2. The second recommendation is that instead of establishing a very ambitious, national scheme for informal workers, government should carry out a smaller pilot(s) of a smoothed defined contributory scheme that can either be along the lines of the scheme presented in this report. Given that the department now has a benefit design and costing tool, the pilot can experiment with different benefit packages and levels of subsidisation. It is likely that a sector specific pilot will be easier to rollout and so government may want to take this route. The pilot (s) should start off by targeting relatively well-organised sectors with incomes that make a small fund sustainable. Examples include those in the arts and culture sectors as well as the more professional types of informal workers.

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ANNEXURES

Annex A: FDG Methodology and participation selection

Four FGDs, each with between five and eight participants, were held in KwaZulu-Natal on 1 and 2 March in 2011. The FGDs provided valuable insights into the feasibility of including informal workers in the proposed retirement system.[40] A high level of interest and willingness to contribute to the system was displayed by participants in all the groups. However, several factors will have to be taken into consideration when designing the system in order to ensure that informal workers are able to participate.

Participant selection

Focus groups were held in Durban in the Warwick Junction area. Participants were selected and facilitated by AeT within guidelines provided by and after discussion with the OPM research team. AeT is a non-profit organisation providing technical expertise to assist informal workers acquire skills and understanding of urban development processes and also serves as a 'learning hub' for those interested in urban planning and the informal economy. The AeT team were an invaluable resource in the FGDs due to their extensive knowledge and experience with informal worker networks in the Durban area. Moreover, the study benefitted from the high levels of trust that workers have in AeT. The organisation has also previously been involved in a wide range of research on the informal sector, including conducting various FGDs with informal workers.

The four FGDs were conducted in isiZulu. Each group differed in terms of the characteristics of the key participants involved, as well as the location and type of work that the participants did. A key consideration in selecting groupings was that retirement provision for informal workers with the lowest incomes in South Africa is currently catered for through the current SOAP. Hence, the proposed contributory system will therefore be most relevant to informal workers with somewhat higher levels of income. As a result, the request to AeT was to select workers in somewhat higher income ranges and not those who can be called the 'poorest survivalists'.

Structure of FGDs

The FGDs, each lasting on average for two hours, had the following components:

- An introduction to the study by AeT;
- **A discussion on participants' thinking and plans for supporting themselves in old age;**
- An introduction to key aspects of the **government's draft proposals for a compulsory retirement system** (see below for the summaries presented);
- **A discussion of key aspects of the government's proposals for the retirement system**, such as willingness to contribute to such a system, how often and how much they would be able to contribute, and potential advantages and problems they foresaw; and
- **IPISs**, which were completed by participants (see below for the questionnaire).

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40 This study into options for the inclusion of informal workers into retirement reform in South Africa does not include a process of consultation with stakeholders. Government will embark on its own consultation process once there is agreement about the initial framework of proposals for a contributory retirement scheme. However, it was decided to include as a small component of the study FGDs with informal workers.

Characteristics of FGD participants

Table A.1 provides a short profile of FGD participants in terms of age, type of work, work history, sources of household income, household size and dependency on worker and grant incomes.

Table A.1 Profile of FGD participants

	Age	Type of work	Other work before this	HH members with income	HH members dependent on [name]s's income	Grant income
Group 1	48	Bovine head seller	None	0	13	No
	33	Trader- pinafores	Farm worker	0	15	Yes
	46	Informal trader	None	0	12	No
	60	Trader- clothing and assorted goods	Private sector (clothing/textiles)	1	4	Yes
	62	Traditional healer	Engineering in Joburg operating mealie machine	0	10 (Clenaville and Maputoland)	Yes
Group 2	57	Trader- jewellery, fruit &veg	Self-employment	0	6	No
	43	Hawker- tobacco, airtime	None	1	2	No
	60	Street trader- shoes	Unemployed	0	10	No
	36	Street trader	School/military service	0	6	Yes
	33	Communications- CellC, public phones	Researcher	4	3	Yes
Group 3	37	Food	Cleaner in Joburg	0	5	Yes
	34	Food/drinks	Restaurant	1	4	Yes
	32	Food	None	1	6	Yes
	46	Food/household goods	Sold ice-cream	0	6	No
	33	Street trader	Farm worker	0	4	Yes
	32	Fruit and veg trader	Student	0	6	Yes
	32	Phone shop and drinks	Student	0	2	Yes
	28	Street trader	Unemployed	1	4	Yes
Group 4	28	Lime seller	School	0		Yes
	35	Lime seller	School	0	7	Yes
	27	Lime seller	School	1	4	Yes
	53	Impepho seller	Unemployed	0	5	Yes
	38	Street trader	Farm worker	0	8	Yes
	28	Impepho seller	School	0	16	Yes
	34	Lime seller	School	1	5	Yes
	27	Street trader	Farm worker	0	9	Yes

HH = Households

The questionnaire did not ask about income and expenditure levels because eliciting accurate information in this regard requires more complex structuring of a questionnaire. It has also been found in the past that informal workers may be reluctant to answer questions about incomes given the fact these are generally not declared to tax and other authorities and there may be suspicion that the study team would hand over this information to these authorities.

However, in order to get some sense of relative living standards, questions on asset holdings (or an 'asset register') were included, as well as questions on savings behaviour. Review of the assets declared by participants and their other characteristics confirm that the four groups covered four different segments of informal workers with predictable differences in asset holding, grant income and savings vehicles. Identifying two broad categories – namely 'common assets' (for example, mobile phones, stoves, radios, etc.) and 'distinguishing assets' (for example, motor vehicle, washing machine, computer and satellite dish) – it is clear that, on average, participants in groups 1 and 2 are more affluent than those in groups 3 and 4. This ranking is also confirmed by information on savings, with a smaller proportion of groups 3 and 4 saving and when saving fewer do this through the formal financial system but rather through *stokvels*. In particular, members of the predominantly rural Group 4 mostly do not use the banking system for savings. While social grant receipts are less common in groups 1 and 2, the household of seven of eight participants in Group 3 and the household of all participants in Group 4 receive social grants.

Table A.2 Relative wealth ranking of FGDs focusing on distinguishing assets

Rank	Group
1	2
2	1
3	3
4	4

Group 1 consisted of four male and one female leaders of five of the 12 markets in Warwick Junction. They belong to various trade organisations, member-based organisations and committees relating to informal workers. In addition to representative positions in these organisations, all participants are informal workers themselves. The group had the highest average age among the various groups (50 years), with ages ranging from 33 to 62 years of age. As representatives of groupings of informal workers they could contribute toward an understanding of their own as well as their members' interests.

Members of Group 1 are predominantly the sole earners in their households. This group also has fewer recipients of grant income relative to groups 3 and 4. The participants in Group 1 who did save have access to formal savings institutions and used bank accounts as their primary savings mechanism. In regard to assets, Group 1 ranked the second highest in terms of relative wealth using an 'asset proxy'. In sum, Group 1 consists of participants who are relatively well-off (particularly compared to groups 3 and 4) and have access to formal savings mechanisms

Group 2 was an all-male group with an average age of 45 (ranging from 33 to 60 years). All are traders from the Warwick Junction area and members of the organisation 'Traders Against Crime'. On average, they have the highest aggregate level of assets in the asset register and seemed to be slightly better-off than the other groups.

Group 2 has marginally more participants who come from households who have more than one income earner than in Group 1. In regard to grant income, we observed that Group 2 had the lowest number of participants earning grant income relative to the other groups. In terms of savings, we found that most Group 2 participants did save and that all but one saved through formal bank accounts and therefore had access to formal savings mechanisms or institutions. In regard to relative wealth measured using an 'asset proxy', we found that Group 2 was the most affluent group relative to the other three participating groups.

Group 3 was a group of women traders from the Bester Market, a peri-urban area with differing characteristics to those of the city centre. The market has recently suffered a loss of business due to the construction of a shopping mall in the area. Most of the women are in their 30s apart from one younger (28) participant and one older participant (46). They predominantly sell food, drinks and basic household goods from containers in the market.

We found Group 3 to have the highest number of participants who came from households with more than one income earner. This may have been due to the fact that the participants in this group were all female, although there is no clear evidence to support this linkage. In regard to grant income, we found that seven of the eight participants in this group receive grant income. This proportion is significantly higher than for groups 1 and 2. In regard to savings, we found that far fewer participants saved with formal financial institutions relative to groups 1 and 2, and that more participants saved using *stokvels*. This suggests that participants in Group 3 have limited access to formal savings or financial institutions relative to groups 1 and 2. In regard to an 'asset proxy', we found that Group 3 ranked third of all the groups. Overall, Group 3 is a relatively less affluent group (relative to groups 1 and 2) but is more affluent than Group 4.

Group 4 was an all-female group of *impepho* and lime sellers (four *impepho* sellers and four lime sellers)[41] operating in the *impepho* and lime market in the Warwick Junction area. The group has the youngest average age (33 years), the lowest level of assets and the highest level of income insecurity. The women come from rural areas and spend two weeks every month gathering *impepho* or mining lime in the rural areas; they then travel to Durban to spend two weeks selling the *impepho* and lime in the market. During their stay in Durban, they sleep in the market that is situated below a highway near Warwick Junction.

Group 4 had a low number of participants who came from households with more than one income. This group also had the highest number of participants receiving grant income relative to the other groups (all eight participants in Group 4 received grant income). In regard to savings, most of the participants who indicated that they saved used *stokvels* to save rather than formal financial institutions. This may be an indication that participants in Group 4 have little access to formal financial institutions. In regard to the 'asset proxy', we found that participants in Group 4 ranked lowest relative to groups 1, 2 and 3. Overall, it appears that Group 4 is the least affluent group and that participants in this group have limited access to formal financial institutions.

Study constraints

While the information from this qualitative research cannot be generalised to informal workers in other locations and in other segments of the informal economy, the four groups included a range of incomes, ages and sectoral groups and included both sexes. While more detailed and extensive consultations with informal workers are necessary, the range of participants selected allows for the information from this study to be both relevant and informative regarding the design and implementation of the proposed retirement savings mechanism.

The study team was unable to test the participants' reactions to the detail and practical functioning of the proposed government schemes mechanism, given that significant details about the proposal are not available yet. As a result, the study team was unable to provide detail on the level of contribution, the extent of government subsidy, the benefit level (pay-out), or the functioning of the risk benefits of the mechanism. Participants did ask about these issues and, in most cases, the team were not able to give concrete answers. This caused frustration among some participants. In spite of these limitations, the team was able to gain an initial sense of the acceptability of the proposed mechanism to participants.

41 *Impepho* is a traditional incense used to communicate with ancestors or to ward off evil spirits. *Umcako* (white lime) and *ibomvu* (red lime) are both mined in Indwedwe, KwaZulu-Natal and are used by trainee and qualified *izangomas* by being applied to the skin. For more information, see www.marketsofwarwick.co.za/mpepho-and-lime-market.

FGD material

Pensions in South Africa

State Old Age Pension

Aim: everybody has **something to live on in old age (poverty reduction)**

The government is thinking of adding a:

New Pension

Aim: that people have a **better income when they are older**
(not such a big drop in income when they stop working)

BUT: It will work on savings; everybody must **contribute**

How will it work?

Save (put away money) regularly over work life
↓
Receive a **monthly pension payout at age 65**

=

New pension system
=
State old age pension (which you **do not contribute** to)
+
New pension (which you **will contribute** to)

The **pension** allows you to:

Reach old age and

↓

Stop working but

↓

Still have an income

The **planned system would *also* cover you for other risks** you may face during your life that would prevent you from working or earning an income

A **disability benefit** means that if you:

Become disabled and are

↓

Unable to work you would

↓

Still have an income

A **death benefit** means that if you:

Die, and are

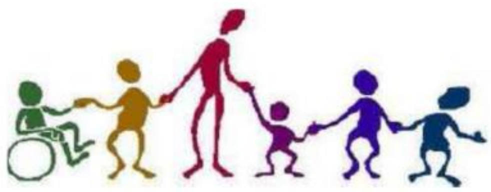
↓

Unable to work, your family would

↓

Still have an income

You and your family are protected if you can no longer work



BUT *only* if you pay into the system!

Individual Participant Information Sheet (IPIS)

- Name?
- Place of residence (Suburb/township where you live)?
- Age?
- What type of work do you do/what types of goods do you trade?
- Place of work/Name of market?
- How long have you been doing this type of work?

  1. What other types of work did you do before this?
- How many people in your household receive grants?
- How many people in your household (other than you and those receiving grants) earn an income?

  1. Please provide the following details of those in the household who earn an income:

Earner	Relationship of earner to you
1	
2	
3	
4	

- How many other people live in the household who do not earn anything and are dependent on you (including children)?
- How many people in total live in your household?

Annex B Actuarial Costing

Annuity rates

Introduction

A DB pension arrangement, as its name suggests, provides a regular pension where the amount to be paid is defined. The replacement ratio, or ratio of pension to salary at retirement, is thus easy to calculate. A DC arrangement, on the other hand, provides a lump sum at retirement that either can or must be used to purchase an annuity. In order to calculate the replacement ratio, it is necessary to calculate the size of the annuity that could be bought with the DC lump sum. In other words, it is necessary to know or to estimate the annuity rates that will be in force at the time of retirement.

Annuity rates depend on several factors: the expected longevity of the annuitant, the expected investment returns that can be earned on the purchase price, and the expected expenses that will be borne by the annuity provider – the latter include administration costs and profit margin. They also depend on whether the annuity payments will increase, whether there is a guaranteed payment period, and whether payments (possibly reduced) will be paid to a beneficiary after the death of the annuitant. Annuities are sold by insurance companies, and like other financial products are subject to competitive pressure. There is an active annuity market in South Africa, with a number of insurers offering products.

However, the annuities with quoted prices cannot be used directly to calculate the amount of pension that would be provided by a DC arrangement because they differ in some important respects from those that would be bought by (or on behalf of) scheme members.

Annuity market

There are around half a dozen annuity providers in the South African market. Comparative rates are available on the web for the following types of annuity:

- Life annuity, level or increasing at 5%, 10-year guarantee period, male or female age 55, purchase price R1,000,000;
- Life annuity, level, 10-year guarantee period, male or female age 60, purchase price R1,000,000; and
- Annuity certain for five years, level, purchase price R1,000,000.

There is at least one provider, Paramount Life, which offers more advantageous rates to those in poor health.

As discussed below, the rates available today are unlikely to be good guides to those that might be available to scheme members in the future.

Scheme annuities

Three of the retirement options are based on defined contributions. Option 3 would require the member to buy an annuity from the proceeds of their retirement account, option 2 would provide guaranteed rates at which the member could buy an annuity, and option 4 would permit the member to buy an annuity.

In all cases, the lump sum that will be available for annuity purchase is likely to be much less than R1,000,000. The annuity that will be purchased will be a life annuity, but is unlikely to include a 10-year guarantee. The annuity may be level or increasing. If it is increasing, it might be linked to inflation. The annuity may be a joint life annuity (if there is a survivors' pension on death in retirement).

Differences

The rates that are currently available in the market are poor guides to those that might be available to scheme members because the annuities will be of different types, the expense loading is likely to be different, and the longevity of scheme members is likely to differ from that of current buyers of annuities.

Annuity type

For a given purchase price, an annuity without a 10-year guarantee period will provide a higher income than one with, and a joint life annuity will provide a lower income than a single life annuity. An annuity with increasing payments will provide a lower level of income than one with level payments.

Expense loading

Smaller annuities are more expensive to administer, so annuity rates are not usually strictly proportional over the whole range of possible purchase prices. Smaller annuities are typically more expensive than large ones, so annuities for scheme members would, other things being equal, be more expensive than the rates that are currently quoted. However, the advent of retirement benefit schemes for the informal sector is likely to change the annuity market quite significantly by opening it up to a new section of the population. Insurers could react by introducing new products specifically aimed at this new market sector. Also, the scheme could develop relationships with preferred annuity providers through competitive bidding, which would tend to drive prices down (i.e. provide a higher income for a given purchase price).

Longevity

Current buyers of annuities are likely to be comparatively wealthy, and to be in the higher socio-economic groups. They are therefore likely to live for longer than typical informal workers, who are less well-off and are from the lower socio-economic groups. This means that annuities for informal workers could provide a higher income for the same purchase price than those currently available.

Summary

The introduction of DC retirement benefits for the informal sector is likely to have a significant effect on the annuity market. Insurers will introduce new products specifically aimed at the new market sector, with rates that will differ markedly from the rates currently available. Some of the differences between the current market and the new entrants will tend toward making the new annuities more expensive, while others will tend in the opposite direction. It is not possible to predict the magnitude or direction of the overall effect. This means that it is not possible to estimate with any accuracy the annuity rates that might be suitable for calculating replacement ratios for the options we present.

Annex C Extract from review on social security (compulsory retirement insurance) for farm and domestic workers in the US

'…. coverage under Social Security [in terms of the Social Security Act of 1935] was not universally perceived as a boon by the workers and employers of the 1930s.

Once the law was passed, one of the major administrative struggles undertaken by the Social Security Board in the early years of the system was the effort to get covered workers and employers to participate—that is, to accept the fact that they were covered. Until the mid-1940s—when benefits were finally flowing in noticeable volume—many workers and employers in all occupational categories tried to avoid coverage. Indeed, the Social Security Board had full-time positions in its field offices called field representatives, and one of their main functions was to go out into the community and find noncompliant workers and employers and convince them that they had to accept the fact that they were covered by the law.

We can gain some insight into the attitudes of domestic workers and their employers by observing what occurred after 1950, when domestic work was brought into coverage There is quite a bit of evidence of resistance from employees and employers alike. One St. Louis housewife told the Wall St. Journal, 'I haven't paid the tax so far, and I'm not going to pay it until someone yells.' A Pittsburgh woman told the Journal, 'I've never given it any thought, and I don't suppose my cleaning girl has either; she's never mentioned it.' According to the Journal's investigation of the issue, 'Many domestic servants queried about the new Social Security provisions said they definitely would object to the withholding from their pay. Some simply don't want to lose the 2% in cash wages.'

One group of domestic-employing housewives in Marshall, Texas formed a rump resistance to coverage, initiating a lobbying campaign and a federal lawsuit against coverage of their employees—a lawsuit they pursued all the way to the U.S. Supreme Court, but lost in January 1954.' Ironically, the housewives' rebellion became a political cause championed by the leading newspaper of the area—the Houston Post—whose publisher, Oveta Culp Hobby, would become Eisenhower's secretary of Health, Education, and Welfare in 1953 and would thus be the federal official charged with responsibility for administering the Social Security Act.

Over the years, domestic workers often tried to avoid coverage, usually by persuading their employers to pay them 'under the table' so that there was no record of their earnings. This would mean, of course, that they would not be eligible for benefits in the future.

We saw evidence of this attitude on the part of these lower-paid workers when the issue of coverage for domestic workers broke into public attention in 1993 with the failed nomination of Zoe Baird to be U.S. attorney general. Baird had been paying her domestic help 'under the table' for years, at the request of her employee. At the time the Zoe Baird case broke into public view, officials of the Internal Revenue Service estimated that only about 500,000 of the 'several million' who employed domestic workers were in fact complying with the coverage requirements of the 1950 law.' What these incidents all reveal is that even now, domestic workers resist being covered by Social Security, and it suggests that they would not in fact have agreed in 1935 that the decision to exclude them was adverse.

Contemporary scholars tend to look back on 1935 from their present vantage points, and they see something of value (Social Security coverage) being withheld from African Americans. But this *distorts the historical context in which the coverage decisions were actually made. There is good reason to believe that many agricultural and domestic workers in 1935 may not have agreed that something of value was being denied them.'*

(Extracted from De Witte (2010). Social Security Bulletin, vol. 70 no.4)

Extract from Ghana Pensions Act (2008) on informal workers

Ghana National Pensions Act, 766 of 2008 on informal workers

Self-employed persons

109. (1) A self-employed person may join and pay contributions to a personal pension scheme if the person is more than the statutory retirement age or is exempted under this Act or is not more than fifteen years of age.

(2) Contributions by self-employed persons in the informal sector who are not covered under the mandatory scheme shall be credited to two separate individual subaccounts

***(a)* The personal savings account, and**

***(b)* The retirement account.**

(3) The proportions to be credited to each account shall be prescribed in the governing rules of the scheme.

(4) A contributor may withdraw part of the contributor's personal savings account in accordance with this Act and the governing rules of the scheme.

(5) The proceeds of the retirement account shall only be paid on the retirement of the contributor as monthly or quarterly pensions.

(6) The provisions of this Act on accrued benefits and the governing rules of the scheme which do not conflict with this Act shall apply to accrued benefits derived from voluntary contributions paid to a scheme under the provident fund and personal pension scheme.

Qualifying conditions for withdrawal of accrued benefits

110. (1) A member who has attained the retirement age is entitled to the entire accrued benefits in the scheme in a lump sum.

(2) A member who has not attained the retirement age may withdraw all or part of the member's accrued benefits from a scheme

(a) after ten years from the date of first contribution in the case of the provident fund or personal pension scheme for contributors in the formal sector,

(b) after five years from the date of first contribution in the case of personal pension scheme for contributors in the informal sector, or

(c) following a certification by a medical board that the contributor is incapable of any normal gainful employment by virtue of a permanent physical or mental disability.

(3) The beneficiaries of the estate of a deceased contributor may withdraw the accrued benefits of the deceased from the scheme.

Retirement benefits

111. A contributor who is not covered under a mandatory pension scheme or any other pension scheme is entitled to

(a) use a percentage of accrued benefits, prescribed by the Board of the Authority to purchase an annuity for life payable monthly or quarterly from a life insurance company licensed by the National Insurance Commission, and

(b) a lump sum payment from the balance standing to the credit of the contributor’s accrued benefits or personal savings account.

Annex D Single governance structure for social protection in South Africa

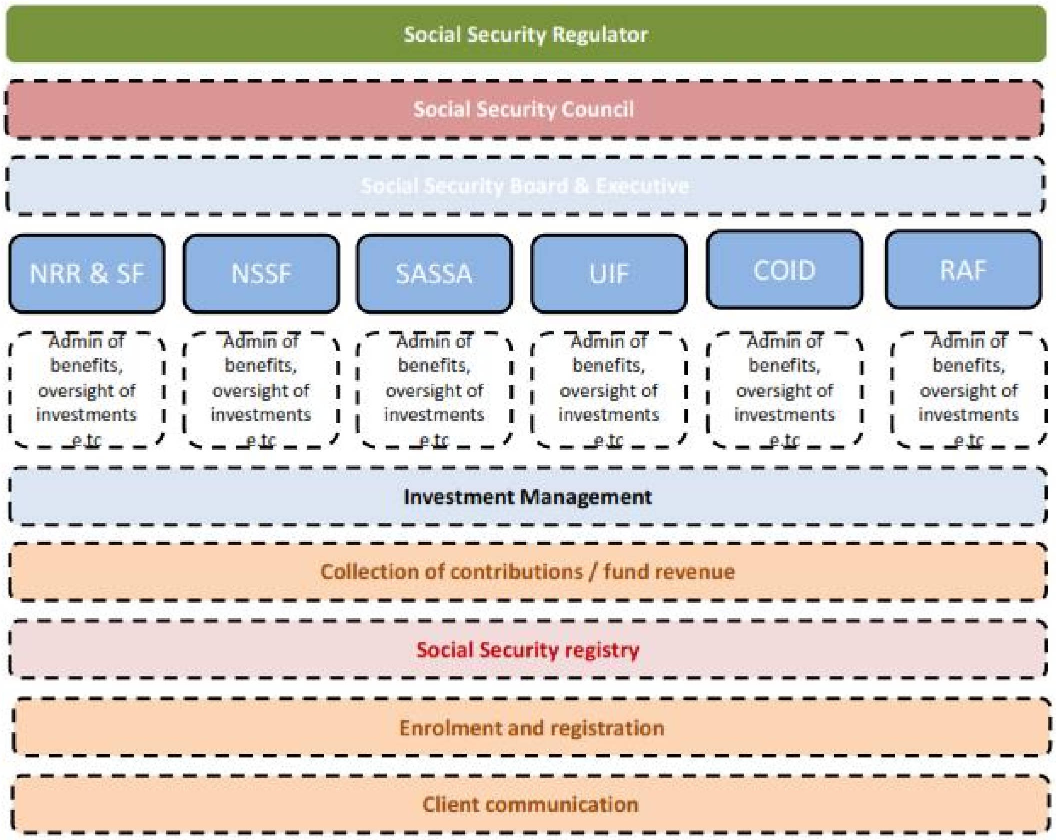
The debate on whether a singular governance structure for social protection is the way forward for South Africa has a long history, with the Taylor Report of 2002 making recommendations for the establishment of a social security agency administering both social assistance and social insurance funds. While SASSA was established in terms of the SASSA Act No. 9 of 2004, leading to it taking over the administration of social assistance in 2006, it has no responsibility for social insurance. This is despite the act leaving room for the mandate of the agency to 'provide for the prospective administration and payment of social security by the Agency and the provision of services related thereto.'

A long-term goal could be to have a single governance structure wherein each social security institution is subject to the authority of a social security board and executive. Oversight for the board (and executive) can be the responsibility of a single social security council, which will in turn report to a minister. Each social security institution and government department (and minister) will retain responsibility for policy formulation. Furthermore, each individual social security institution will retain its board and will nominate members to the overall social security board (and executive).

Ideally, the social security council, board and executive will have representation from (among others) social security institutions, relevant government departments, stakeholders such as trade unions and employer associations, as well as nominated independent members such as academics, actuaries, etc. The Social Security Board will have to be supported by a social security executive.

The unified governance structure could also result in cost savings to be made with respect to the procurement of services such as investment management. For instance, all social security institutions could have pooled investment management and other services such as annuity providers can also be jointly contracted.

Figure E.1: Proposed alternative administrative structure for a NRRSF



The client interface for such an option could be such that there is a one-stop public social security interface entity, with branch offices and walk-in centres accessible to all citizens. A single stop social security entity would be able to standardise service standards across all social security entities by providing the following services for all social security institutions: processing of applications, facilitating links with supporting government services such as those offered by the Department of Home Affairs; complaints management; communication with the public through different media including a call centre and web-based platforms; acting as cash points for payment of beneficiaries; and maintaining a single social security registry.

For many social security institutions under this structure, not all these services will be most efficiently delivered exclusively through a one-stop shop. For example, for the NRRSF proposed here, aggregators such as workers unions may be better placed to provide enrolment and communication services as they have better access to their constituents. The same applies to other functions such as the collection of contributions, which could be accommodated under one system more easily for many of the institutions than for others. For instance, SARS could be given the role of collecting revenue for all institutions under the unified structure. However, for the NRRSF proposed in the current study, this might not be the best approach to collecting contributions from informal workers.

Even with a one-stop service centre, each social security organisation will still be responsible for the administration of benefits, including the maintenance of member accounts an entitlements, payment of beneficiaries (in cases where direct cash or cheques are not used) and oversight of social security investments. Underpinning this whole unified structure should be a central registry for all social security institutions.

Because each existing social security institution has its own administrative platform and since both the NRRSF and the NSSF are currently not in place, this unified administrative structure should not be imposed and should instead be allowed to take shape in a more organic and phased way.