

Falling through the Cracks

Income Security and the South African Social Security System

by

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DECLARATION

I, the undersigned, hereby declare that the work contained in this thesis is my own original work and has not previously in its entirety or in part been submitted at any university for a degree.

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ABSTRACT

This thesis focuses on the extent to which the South African social security system succeeds in providing protection in the vulnerable periods of the life-cycle and against the major contingencies of unemployment, disability and disease. Through a detailed examination of the different social insurance and assistance programmes, it isolates which particular population segments (by occupation, income quintile and race group) “fall through the cracks” in the provision of income security. It does not look only at the articulation between different social insurance and social assistance programmes, but also acknowledges how social security complements other governmental interventions, such as social services, and non-state sources of income security, such as those provided by the private insurance market and the family and community.

Part One of the thesis is devoted to an examination of social insurance in South Africa, in other words, to those programmes that seek to compensate for a loss of income in the event of particular contingencies and that are funded by contributions from employers and employees. In addition, theoretical perspectives on social security, and social insurance in particular, are provided, with a discussion of the various economic arguments in favour of and against the provision of social security.

Part Two of the thesis examines the range of non-contributory social assistance - cash benefits paid from general revenue - that are available to South Africans who qualify in terms of the means tests. Each chapter provides an analysis of the extent to which the social assistance programme under analysis provides a safety net for the relevant category

of vulnerable people. It does this by examining the appropriateness of the programme structure, take-up rates and the fiscal sustainability of the programmes. In addition, the budgetary process by which revenue is allocated to social assistance programmes and expenditure trends are examined.

The thesis concludes that although the South African social security system has achieved a fairly advanced level of development and covers a fairly wide range of risks, there are a number of constraints facing its further expansion. Social insurance schemes provide generous benefits, but their membership is restricted to the employed. Expanding coverage by social insurance would require substantial growth in remunerative employment which, given prevailing labour market conditions, seems unlikely. The provision of more generous social assistance programmes catering for a broader range of contingencies is severely curtailed by already high fiscal expenditure on welfare and macroeconomic constraints. Moreover, changing demography, household structures and dependency burdens, especially as the HIV/AIDS epidemic spreads, seem likely to increase demands on social assistance programmes. Consequently, until employment can be expanded so that more people can contribute to their own income security, the informal social security provided by the family and/or community will remain the first line of support for many.

Opsomming

In hierdie tesis word gefokus op die mate waartoe die Suid-Afrikaanse bestaansbeveiligingstelsel daarin slaag om ondersteuning tydens kwesbare periodes in die lewensiklus en beskerming teen groot gebeurlikhede soos werkloosheid, ongeskiktheid of langdurige siekte te bied. Daardie bevolkingsegmente (volgens beroep, inkomstegroep of ras) wat nie volledig toegang tot inkomstesekuriteit het nie, word uitgesonder deur 'n gedetailleerde ondersoek van die verskillende maatskaplike versekerings- en bystandsprogramme. Daar word ook gekyk na die artikulasie tussen die verskillende programme sowel as na hoe ander regeringsintervensies (bv. verskaffing van maatskaplike dienste) en private bronne van inkomstesekuriteit - verskaf deur die privaat versekeringsmark, die gemeenskap en die familie - deur maatskaplike bystand aangevul word.

Deel Een word gewy aan 'n ondersoek van maatskaplike versekering in Suid-Afrika – daardie programme wat vir inkomsteverlies weens spesifieke gebeurlikhede probeer kompenseer en wat tipies deur bydraes van werkgewers en werknemers befonds word. Teoretiese perspektiewe op bestaansbeveiliging in die algemeen en maatskaplike versekering in besonder word ook verskaf en argumente vir en teen die verskaffing van bestaansbeveiliging word bespreek.

Deel Twee ondersoek die reeks nie-bydraende bestaansbeveiligingsprogramme wat uit algemene owerheidsinkomste befonds word, asook bestedingstendense in maatskaplike bystand.

Die tesis kom tot die gevolgtrekking dat, alhoewel Suid-Afrikaanse bestaansbeveiliging 'n redelik gevorderde vlak van ontwikkeling bereik het en 'n wye reeks risiko's dek, daar 'n aantal beperkinge op verdere uitbreiding is. Maatskaplike versekeringskemas bied uitgebreide voordele, maar lidmaatskap is tot indiensgeneemdes beperk. Uitbreiding van dekking vereis beduidende groei in formele indiensneming, wat onwaarskynlik lyk, gegewe huidige arbeidsmarktendense. Die verskaffing van gunstiger maatskaplike bystandsprogramme gemik op meer gebeurlikhede word ernstig deur reeds hoë fiskale uitgawes op welsyn en deur makroekonomiese oorweginge beperk. Verder sal veranderende demografiese strukture, huishoudingstrukture en afhanklikheidslaste, veral teen die agtergrond van die toename in HIV/VIGS, aansprake op maatskaplike bystandsprogramme vergroot. Gevolglik sal die informele inkomstesekuriteit gebied deur die familie en/of gemeenskap die eerste of enigste ondersteuning vir groot dele van die bevolking bly, totdat indiensneming genoeg uitgebrei kan word sodat meer mense tot hul eie inkomstesekuriteit kan bydra.

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DEDICATION

To my parents

who have given me the very best of life's chances

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INTRODUCTION

1. South African Social Security in a Global Context

Any discussion of South African social security requires some sort of conceptualisation of what is understood, internationally, by social security. The bulk of the social security literature originates in the advanced economies of Europe and North America and, thus, draws on the development of social institutions in those countries. In some of these states, social policy is an important area of government expenditure, but competes for priority side by side with other traditional budgetary priorities. However, in other countries, particularly in Europe, social objectives are so closely intertwined with all aspects of policy-making that these countries are now defined in terms of their welfare goals - as "welfare states". Not only have states deeply penetrated education, health, housing and welfare institutions, but they also actively direct other policy areas toward welfare goals.

The extent to which this has occurred varies from country to country. As a result, researchers dispute the parameters of welfare states and social security regimes (see, for example, Flora and Heidenheimer 1984: 17-34, Atkinson 1993: 5-9, Barr 1998: 6-12, Esping-Anderson 1998: 9-34). Their definitions range from narrow ones that focus purely on government expenditure on social security transfers and social services to those that look at the sum total of government intervention in the economy including issues of employment, wages and overall macroeconomic strategy. "Those who take the narrower view see it in terms of the traditional terrain of social amelioration: income transfers and social services...the broader view often frames its questions in terms of political economy, its interests focused on the state's larger role

in managing and organizing the economy” (Esping-Anderson 1998: 1-2). The features of welfare states in advanced economies enable them to be clustered into three main groups. The corporatist welfare states of continental Europe, the liberal welfare states of the United States and the United Kingdom and the Nordic social democratic or universalistic models are the standards of social security literature. Indeed, the elements of most modern social security legislation, even in developing countries, find their origins in the evolution of these systems, in particular in the Beveridge and Bismarckian welfare states.

While many developing countries have tried to emulate components of these systems, adjusting for national priorities, by and large they cannot be said to have developed fully-fledged welfare states. Budgetary constraints, labour market challenges, the absence of a consolidation of power and social, economic and political instability have, in most cases, only allowed for the establishment of very rudimentary social security systems. Programmes within these systems are not necessarily consistent with each other or suitable to the socio-economic environment and can often better be described as a conglomeration of fragmented programmes that have been built up in a piecemeal fashion, rather than a systematically structured unity.

South Africa, too, faces a number of challenges and constraints that restrict the development of a more comprehensive social security system. Severe fiscal constraints, a rather rural character, widespread poverty and a high level of structural unemployment render many typical social security programmes inappropriate in the South African context. The tenuous attachment of most people to the formal market and the prevalence of informal sector employment render social insurance ineffective

in providing security to much of the labour force. In addition, poverty and income uncertainty is the norm rather than the exception, social assistance draws on a very narrow tax base and survival is often dependent on subsistence and non-market activities. Demographic factors, such as a youthful population structure, significant population growth, large and complex family and household structures and the rapid spread of AIDS pose challenges that are not faced by social security systems in the advanced economies. Consideration also needs to be given to the extreme inequalities and racial bias in levels of material well-being that result from decades of apartheid practices. South African social security cannot simply emulate the models of other countries, but has had to, and must continue to, adapt to meet the very unique combination of domestic challenges.

2. An Introduction to South Africa's Social Security System

For a middle income country, South Africa's social security system is very well developed. Its most generous benefits are provided through social insurance, with residual social assistance schemes.

Social insurance operates on the basis of earnings-related contributions - to unemployment insurance, workmen's compensation and occupational old age pension funds. In this way, the most generous social entitlements derive principally from employment rather than from citizenship as is the case, for example, in the universalistic Nordic welfare states (Esping-Anderson 1995: 3). In addition, the social assistance benefits provided on the basis of proven need such as means-tested social old age pensions, although substantial by the standards of developing countries, are set at a low level relative to occupational insurance benefits. Also, social assistance

grants only cover very specific categories of people with no assistance provided to the unemployed who constitute a large percentage of the adult population. Social relief is only provided for a very short period and for very limited eventualities.

The important consequence of this is that social security payments tend to reflect entrenched status and income differentials. As a result, the redistributive potential of social security and its potential to enhance social integration are weak and it would appear that South Africa's social security system is not orientated towards reducing inequalities or changing the racial composition of poverty. Rather, the objective of income maintenance predominates. Furthermore, the primacy of social insurance also encourages female dependency as it promotes dependence on the formally employed household members, whom are more often male. Those who benefit most from the South African social security system are the formally employed, who can take advantage of the social insurance programmes, and those with low incomes, who are eligible for social assistance benefits.

3. The Approach taken in this Thesis

This thesis focuses on the extent to which the South African social security system succeeds in providing protection in the vulnerable periods of the life-cycle and against the major contingencies of unemployment, disability and illness. Through a detailed examination of the different social insurance and social assistance programmes, it seeks to isolate who "falls through the cracks" in the provision of income security. It does not look only at the cracks at the intersection of different social insurance and social assistance programmes. It also acknowledges how, given the residual nature of South African social security system, social security complements other governmental

interventions, such as social services, and non-state sources of income security, such as those provided by the private insurance market and the family and community. Thus, by recognising that each social security programme is merely one of many layers of social support, social security is examined as a unified system, rather than as a simple aggregate of individual programmes.

This thesis will reveal that there are certain groups of people who are not protected against specified contingencies either through state or non-state support. It is concerned not only with the range of contingencies covered by social security but with the coverage of different population segments (according to occupation, race and geographic location) by these programmes. This information will enable some tentative conclusions to be drawn about the potential of the different programmes to alleviate poverty and redistribute income. Other considerations are whether, given current benefit levels, take-up rates, demographic forecasts and labour market conditions, the social security system as it is currently structured is administratively efficient and fiscally sustainable.

Chapter 1 examines the economic rationale for the provision of social security. It sets out the objectives of social security and examines the economic costs that may be involved in achieving those objectives, in terms of labour market flexibility, disincentive effects and the impact on net savings, investment and economic growth. It also highlights the different targeting approaches that can be used to allocate social security benefits.

Part One of the thesis (Chapters 2-6) is devoted to an examination of social insurance in South Africa, in other words, to those programmes that seek to compensate for a loss of income in the event of particular contingencies and that are funded by contributions from employers and employees. Chapter 2 provides a theoretical perspective on the nature of social insurance and describes how the demand for social insurance is created through the failure of the private market to supply the desired quantity of insurance at the desired price. Chapters 3, 4, 5 and 6 analyse social insurance programmes for retirement, unemployment, occupational disability and disease, and road accidents respectively. In addition to a discussion of the contributions and benefit structures, particular attention is paid to the coverage of different population groups by each programme and any articulation between these social insurance schemes, private insurance schemes and social assistance programmes.

Part Two of the thesis (Chapters 7-10) examines the range of non-contributory social assistance transfers- cash benefits paid from general revenue - that are available to South Africans who qualify in terms of the means test. Chapter 7 looks at the administration of grants and analyses the budgetary process by which revenue is allocated to social assistance programmes. It also highlights expenditure trends and patterns. Chapters 8, 9 and 10 examine the different social assistance benefits available to the aged, the disabled and care-givers of young children. Each chapter attempts to provide an impression of the extent to which the social assistance programme under analysis provides a safety net for the relevant category of vulnerable people. It does this by examining the appropriateness of the programme structure, the take-up rate of each benefit, the fiscal sustainability of the programmes

and the articulation between the benefit and other sources of governmental and non-governmental support.

Finally, the Conclusion in Chapter 11 highlights the most important conclusions that can be drawn from this thesis.

CHAPTER 1

THE CASE FOR AND AGAINST THE PROVISION OF SOCIAL SECURITY

1. Introduction

One of the most fundamental questions that can be asked in this subject area is "Why is there a need for social security legislation?" Different countries and governments at different times have given different answers to this question and, consequently, have developed diverse social security systems. The unique social, economic and political contexts in which systems are designed determine the emphasis placed on different programmes. The importance given to social security compared to other national priorities informs the type of legislation, nature and generosity of benefits within a system, and the reciprocal obligations of the recipient. The different objectives of social security systems are discussed in section 2 of this chapter.

The improvements in material well-being that result from social security programmes are somewhat offset by the economic inefficiencies and administrative costs that may accompany them. Benefit schemes have been accused of creating labour supply disincentives, raising unemployment levels and negatively impacting on net savings and economic growth. In addition, they can be expensive to administer. These economic (allocative) and administrative costs will be considered in section 3 of this chapter.

Finally, in section 4 of this chapter, consideration is given to one of the ways through which the objectives of social security systems can be enhanced and the costs or inefficiencies minimised – effective targeting.

2. The Objectives of a Social Security System

Most social security programmes strive to achieve one or more of the following objectives:

2.1 The Alleviation of Poverty

Historically, the major objective of social protection legislation has been the alleviation of poverty. Some of the earliest formal social security provisions emerged in Britain where, already in 17th century, the Poor Law Act made provision for the accommodation of the “impotent poor” in almshouses and the employment of the able-bodied poor in “houses of correction” (Barr 1998: 16). It was followed by the Speenhamland system of wage subsidies in the 1790’s, the Poor Law Report and Amendment Act of 1834 that provided highly stigmatising relief to the indigent, and some early social legislation in industry, education and public health. As the provision of social policy legislation gained momentum, on the European continent and elsewhere, so did its criticisms. Orthodox Marxists, for example, claimed that the introduction of poverty alleviation measures was not born of altruistic motives. Rather, the provision of a minimal social safety net aimed at retarding the process of alienation and antagonism towards the capitalist bourgeoisie, hence delaying the proletarian revolution and ensuring the maintenance of the existing class structure.

Therefore, for Marxists, the initial intent of social protection was to "control, not emancipate the emergent working classes" (Esping-Anderson 1995: 2).

As the 20th century progressed, however, the alleviation of poverty became an increasingly important social objective. Poverty policy increasingly emphasised the delivery of poverty relief in a way that ensured the dignity of recipients (Atkinson 1993: 6), without the stigma often associated with "being on welfare". The concept of poverty widened in scope so that poverty lines in the advanced economies came to be set far above subsistence level. Amartya Sen introduced what is one of the most holistic views of poverty, defining it as "capability deprivation" (Sen 1995: 15). In other words, a person is considered poor if he lacks the "opportunity" to achieve some minimally acceptable level of certain functions – functions that can be anywhere along the spectrum from elementary physical functionings to complex social achievements. What is important about Sen's definition is that it notes that poverty does not depend on personal income only, but on one's personal circumstances and social surroundings (the "opportunities") because these are needed if personal incomes are to be converted into capabilities to function. If this changing conceptualisation of poverty is to be of any tangible benefit to the poor, then social security legislation needs to embrace this change. If social security systems are not designed to meet the needs of the newly defined "poor", then a new conceptualisation is of little practical value. To estimate the extent to which this has occurred is beyond the scope of this thesis. Suffice to say that, in many countries, the utilisation of the benefits and services provided by the welfare state is so much part and parcel of every day life that most of the population is reached, while in other countries, social security benefits remain residual – a safety net for the very poor – or even rudimentary.

2.2 The Avoidance of Social Exclusion

A second, more recent objective is that of avoiding social exclusion. "Social exclusion" is a European concept that is related to individuals' capacity to exercise their social rights and integrate into society. It refers particularly to integration through stable adequately remunerated employment and is one of the objectives included in the Maastricht Social Policy Accord (Atkinson 1993: 6). Although a low standard of living or a low level of resources is a necessary condition for social exclusion, the concept encompasses much more than this. Social exclusion occurs when individuals are systematically and simultaneously disadvantaged on a number of terrains. It is the "multi-dimensional character of disadvantage and exclusion in modern market economies, i.e. in the areas of work and income, but also in housing, health, access to social services, and, characteristically, culture" (Cantillon, Marx and Van den Bosch 1996: 3). The concepts of multiple deprivation or "cumulative misery" are also used by Schuyt and Tan (Cantillon, Marx and Van den Bosch 1996: 3). For them, the poor are made up of diverse groups of people with no single characteristics in common except perhaps that they lack a stable well-paying job (Cantillon, Marx and Van den Bosch 1996: 4) and that they are geographically concentrated. To some authors social exclusion has become such an integral element of poverty that they define the latter in terms of the former. For example, Engberson writes that modern poverty can be described as "the structured exclusion of citizens from social participation, coupled with permanent dependence on the state" (Cantillon, Marx and Van den Bosch 1996: 3). Poverty is characterised by financial strain, social isolation, little benefit from government services and a passive acceptance of one's situation and of bureaucratic control over one's private life. The equivalent American concept is that of the "underclass", defined as a subset of the poor, including those "whose poverty was

somehow attributable to their behaviour" (Jencks in Cantillon, Marx and Bosch 1996: 2). The (stereo)typical example is of ghetto living conditions where people are constantly in contact with others in similar positions of poverty, i.e. "their marginal economic position or weak attachment to the labour force is uniquely reinforced by the neighbourhood or social milieu" (Wilson in Cantillon, Marx and Bosch 1996: 2).

2.3 Income Maintenance

Social security legislation also attempts to maintain the individual's accustomed level of income over time, i.e. it aims at providing economic security. Barr (1998: 10) identifies two aspects of this broader objective, namely the aim of providing insurance and the aim of income-smoothing. The former provides protection against unexpected reductions in living standards in the face of defined major contingencies while the latter is concerned with predictable fluctuations in income. In the case of insurance, the state facilitates the establishment of social insurance funds to provide for the risks of unemployment and disability, for example. Income-smoothing involves the reallocation of consumption over an individual's life-cycle; over what Rowntree in 1901 identified as the "five alternating periods of want and comparative plenty" (Atkinson 1993: 6). Thus, pensions are provided to the elderly who are no longer earning an income and special benefits are provided to young children from poorer families. The strengthening of the income maintenance objective over time becomes evident if one compares the generous replacement rates of modern income-related contributions and benefits systems to the flat-rate subsistence level benefits and contributions of the Beveridge social security schemes. Today, the objective of income maintenance is becoming increasingly important, e.g. as life expectancy rises,

single-parent households become more common and the “new economy” creates uncertainty as to employment prospects.

2.4 The Reduction of Inequality

A fourth objective of social security legislation, and social policy in general, is to secure a socially optimal distribution of income or to reduce inequality. If it considers social welfare as a whole to be a function of the distribution of income, the government might choose to redistribute income through the tax and social security systems (Dilnot and Walker 1989: 6). This objective is very different from the original intention of social protection legislation. The social insurance funds which were first developed in the “Wohlfahrtsstaat” of late 19th century Germany, for example, were intended to follow occupational divisions, with benefits related to prior earnings, thus maintaining income differentials. There was no question of redistribution. Social assistance programmes, too, sought predominantly to provide a basic safety net for the very poor and not to effect a transfer of wealth. Although the objective of income maintenance tends to dominate advanced social security systems, today many social programmes are designed with the express intention of reducing inequalities. Not only vertical inequality, but also gender and regional inequalities are often targeted (Atkinson 1993: 6).

2.5 Conclusion

It is important to understand the objectives of a particular social security system when one intends to evaluate the effectiveness of the system. The success of a particular policy measure can only be evaluated in terms of the goals it intends to achieve. Often

the apparent objective of a specific measure is different from its true objective, or an intervention designed to improve a specific situation may miss its target.

Related to this point is the need for a system's objectives and structure to be harmonised. The objectives of a system should inform the system design and benefit structure. This is where the straightforward replication of systems that have enjoyed success in other countries may be problematic: it may result in a benefit structure that is incompatible with domestic social policy goals. Similarly, over time, a particular country may “outgrow” its benefit structure as its social objectives change. Dilnot and Walker (1989: 5-7) succinctly describe this danger in their criticism of British social security literature:

“Far too often, social security policy is discussed without a serious consideration of why we have a social security system and what we want it to achieve. In the UK, for example, there has been a lengthy debate as to whether universal or means-tested benefits are the most desirable form of payment, with all too little attention given to the reasons for having benefit payments at all...What appears to be lacking is an adequate consideration of which objectives should have priority, and of whether the current mix of benefit regimes is likely to achieve these objectives most effectively.”

Although this chapter does not formally state the goals of the South African social security system, it will become clear that all four of the above-mentioned objectives are present, with varying degrees of importance attached to them.

3. The Economic Costs of Social Security

In practice social security systems have been able to advance fairly successfully towards these objectives. Without a doubt, comprehensive social security systems have been able to reduce poverty and moderate income disparities between upper and lower income earners. Social insurance institutions protect workers and their dependants from severe income losses due to retirement, disability and unemployment. Together with social assistance transfer payments, this helps to maintain social stability, particularly in periods of recession. Were it not for this protection, the burden of care for the indigent would fall on other members of society.

The successful pursuit of the abovementioned four objectives is subject to a number of constraints, however. It is dependent on the exact structure of its programmes and the manner in which they are implemented, as well as the broader political, social and economic environment. Limited fiscal resources, imperfect information, government failure, perverse incentive effects and human error all pose challenges to the design of a social security system. In striving to attain these objectives, government needs to consider these constraints. The social security system must be structured in such a way that it is economically efficient and administratively feasible. In addition, attention must be given to issues of equity.

3.1 Equity Considerations

There are two dimensions to this criterion, namely vertical equity and horizontal equity. Vertical equity requires that the system redistribute towards those with lower incomes. This objective can be achieved through means-tested benefits or non-means-

tested categorical benefits that are targeted at those segments of the population who are more likely to be poor. Horizontal equity requires that differences in benefits reflect relevant differences in the recipients' circumstances such as age, family size, numbers of dependants, etc., but not differences that do not influence the extent of poverty, such as ethnic background. Thus, in South Africa for example, horizontal equity does not require that racial differences be taken into account. Race is merely a convenient indicator for targeting because the incidence and depth of poverty is systematically higher for certain race groups.

The extent to which social security systems effect a redistribution of income is a product of a complex constellation of factors. Examples of these factors include the objectives prioritised by the particular system, the severity of existing inequalities, the historical pattern of privilege, social stability and the prevailing political sentiments. The amount of redistribution that is considered desirable depends on the specific regime's conceptualisation of what constitutes an equitable and just distribution of income.

3.2 Economic or Allocative Efficiency

Given constrained fiscal resources, it is desirable that social security programmes should conform to the economic objective of allocative or external efficiency. This implies that social programmes should maximise macro- and micro-efficiency and minimise adverse incentives. Macro-efficiency means that an appropriate proportion of Gross Domestic Product (GDP) should be devoted to the welfare budget so as, for example, to avoid distortions that may lead to cost explosions. Micro-efficiency refers to an efficient allocation of welfare resources among the different cash benefits and

welfare services. Special attention will be given to macro- and micro-efficiency in Chapter 7 where the budgetary costs of social assistance are considered.

Although the budgetary cost of social security is the most obvious and quantifiable cost, it is certainly not the only financial cost involved. The full financial burden of social security falls not only on the state, but also on employers and employees. Consequently, a fleeting comparison of cross-country governmental social security expenditure misrepresents the true extent and cost of social security systems. Adema and Einerhard (The Economist 1998) conducted an interesting study of social expenditure in the OECD countries to illustrate this. Calculations based on gross public social expenditure suggest that Sweden is the biggest spender with 36 per cent of its GDP devoted to social spending, while the United States is the smallest at 17 per cent. However, when the figures are adjusted to include benefits provided by private employers, the taxation of benefits and tax incentives offered to firms to provide benefits, the gap between Sweden and the United State's total social spending shrinks to 2.5 percentage points. Although Adema and Einerhard's study looks at total social expenditure and not at social security in particular, it nevertheless illustrates the point that one needs to look beyond fiscal allocations to measure the full economic impact of social security systems.

In addition to the financial costs of social security, there are other economic costs to be considered. Social protection programmes may create a number of distortions and inefficiencies in the economy through their impact on the behaviour of individuals and firms. Indeed, it is for these inefficiencies, rather than their budgetary cost, that social security systems are most frequently criticised. While some writers hold that

welfare institutions are necessary and desirable institutional elements of a well-functioning modern advanced state, others are not as enthusiastic, especially with respect to the distortions that they claim are created by social security programmes. They argue that generous social security institutions and economic efficiency are incompatible; that there is a trade-off between social protection and economic flexibility (Blank 1994: 1). Most of these arguments point to the distortionary loss of welfare that these interventions supposedly introduce in perfectly functioning markets. In other words, social security interventions are criticised for creating incentives for individuals to make different choices and to alter their behaviour, resulting in a sub-optimal outcome. When the impact of social security regimes is evaluated, cognisance needs to be taken of the fact that these interventions may have some adverse effects. Atkinson, for example, points out that the alleviation of poverty and redistribution of income can “only be taken as accurate measure of the effectiveness of the welfare-state in reducing poverty and income inequality if the existence of transfers has no impact on other sources of income” (Atkinson 1993: 8). This section discusses some of the economic distortions and inefficiencies that may arise as a result of social security interventions.

3.2.1. Labour Market Flexibility

A criticism frequently levelled at generous social security systems is that they restrict labour market flexibility (Haveman 1996, International Monetary Fund 1995, Blank and Freeman 1994). This inflexibility is caused by, among other things, high levels of benefits, benefits of long duration, generous eligibility criteria and substantial employer contributions. This is aggravated by the fact that states with generous social

security systems often exhibit other labour market features that inhibit flexibility, such as highly unionised labour, centralised wage bargaining, high minimum wages, restrictions on the hiring and firing of employees and a number of non-wage labour costs, such as paid vacation. The effect of this inflexibility is to limit the ability of actors, both firms and employees, to adjust to changes in the economy. Moreover, it tends to protect the employed at the expense of the unemployed, aggravating long-term unemployment especially among low-skilled and first-time job seekers.

The debate on the trade-off between economic flexibility and social protection gained momentum in the late 1980's following the divergence in economic performance between European countries and the United States. While the United States moved successfully out of the recessionary mid-1970's, European countries continued to exhibit slow growth and escalating unemployment. It soon came to be widely accepted that the generous welfare states of Europe were to blame: generous social protection provisions limit the market response to unemployment by preventing workers from shifting rapidly from slower- to faster-growing segments of the economy (Blank 1994: 1). In social-democratic Sweden, for example, the social security system, in conjunction with public sector monopolies of social services and an inflexible labour market, was blamed for the low productivity growth, high unemployment, strong inflationary bias and recurrent budget deficits of the early 1990's (Lindbeck *et al* 1994: 1-21). Following the "Swedish Crisis" in 1992 when a world-wide recession forced the Swedish authorities to devalue the krona, it was recommended that the social security system be reformed so as not to "undermine the efficiency of the economy through distorted incentives or large budget deficits" (Lindbeck *et al* 1994: 213). Experience in the liberal welfare states on the other side

of the Atlantic seemed to support the notion of a trade-off. It was the “very weakness of North American labor market institutions and welfare states (that were) regarded as the reason for the comparative success of both national economies at generating jobs and restraining the growth of long-term unemployment” (Myles 1994: 2).

Despite the wide acceptance of this connection, the evidence is not conclusive. A study by Blank and Freeman failed to find much empirical evidence of large trade-offs between labour market flexibility and social protection programmes “in general” (Blank 1994: 4) and using similar data sets other researchers were able to question Lindbeck’s findings (see, for example, OECD 1997). Moreover, those who counter that generous social security arrangements are indeed compatible with economic growth can relate contrary experiences in different countries.

3.2.2 Labour Demand and Supply Incentives and Unemployment

Part of the broader debate on the relationship between economic flexibility and social protection, the creation of labour demand and supply (dis)incentives has received much attention in social security literature. The payment of contributions to social insurance funds and the receipt of benefits distort the labour supply decision of workers and the labour demand of employers. Together with the restrictive labour market regulations that usually accompany generous social security systems, this limits actors' ability to freely adjust to changes in the labour market.

3.2.2.1 Labour Demand

On the demand side, employer contributions to social insurance funds drive a wedge between the cost to the employer of taking on an extra worker and the net amount the worker actually receives. This means that total labour costs and, thus, total production costs rise, making it more difficult to compete on world markets, especially for labour-intensive industries. In some OECD countries, such as Italy and Germany, firms now spend twice as much on total employment costs as they do on wages¹ (The Economist 1998). It also appears that non-wage labour costs are increasing: between 1979 and 1995, the size of this tax wedge rose in 15 out of the 23 OECD countries (The Economist 1998). Also in South Africa, employer contributions on behalf of employees markedly increase labour costs, sometimes adding “as much as 30 per cent, or even more to the wage bill” (Baskin 1996: 15). Such a large differential distorts the labour demand decision of employers and may encourage them to behave in socially inefficient ways. For example, the expense of social security contributions made by employers may make it unprofitable to hire low-wage labour, induce firms to conceal income or hire black market labour (Blank and Freeman 1994: 30). It may also encourage the substitution of temporary employees for permanent workers, which reduces the extent of job training offered and prevents the establishment of long-term employer-employee relationships (Haveman 1996: 6). Or firms may simply reduce their demand for labour and increase their capital-labour ratio, hence aggravating unemployment.

¹ This large differential is not only due to high social insurance contributions, but also to other non-wage labour costs.

3.2.2.2 Labour Supply

In terms of labour supply, social security programmes are held to drive a wedge between individual utility-maximising outcomes and the socially efficient outcome (Blank and Freeman 1994: 30). In other words, the payment of social contributions and/or receipt of benefits may affect the individual's labour supply decision so that he substitutes leisure for work, to the detriment of society as a whole.

When analysing the effects of pensions on labour supply, there are two sides to the issue: i) the effect of the payment of contributions on labour supply and ii) the effect of the receipt of benefits on labour supply.

i) Employees, particularly younger ones, often ignore the future benefits of social security when making employment decisions, i.e. they simply respond to the lower net wage after social security deductions. Thus, for them, pension contributions are seen to widen the gap between gross wages and net money wages in the same way as an increase in income tax. This may create an incentive to work less or exit the labour market. But this effect, if any, is small, as the wage elasticity of labour supply among primary earners is known to be low.

Where future benefits bear an actuarial relationship to contributions and workers wish to smooth their income, there should be no disincentive to work. Contributions will be perceived as the price of insurance and, as such, will have little distortionary effect on labour supply. Indeed, many workers desire occupational insurance because it is

cheaper than private alternatives, as employers (are perceived to) pay half of the contributions

ii) It is traditionally argued that unemployment benefits reduce the financial incentive for an unemployed person to seek work, especially if benefits have a very high replacement rate. In other words, unemployment benefits may induce an unemployed person to raise his reservation wage, lengthening the period of unemployment. The person finds himself in an “unemployment trap” where he has little incentive to apply for low-paid jobs. On an aggregate level, however, there should be no adverse effects because in a society with (high) unemployment that job will be taken by someone else. Benefits may slow the rate of entry into employment, but not increase overall unemployment. A possible way to deal with this is to limit the duration of unemployment benefits or to progressively reduce the value of the benefit as time proceeds. An alternative is to make the receipt of benefits conditional on proven job search. Proof of the effectiveness of the former can be found in a study by Hanratty (quoted in Blank 1994: 13) who found that limiting the duration of income support for mothers in France seemed to increase women’s labour market involvement. In addition, the government could choose for an active labour market policy where placement and counselling services, training and job creation are emphasised (see, for example, Schmid, Reissert and Bruche 1992: 163-180).

In the case of old age pensions, there can be no labour supply effect once benefits are being received, of course, but the attraction of future benefits may induce early retirement. With increasing life expectancy, this can place substantial pressure on fiscal resources because beneficiaries will turn to social assistance if their

accumulated annuity proves insufficient. Social assistance considerations aside, there may be considerable efficiency gains associated with early retirement. Firms may reap a productivity dividend and increase competitiveness by shedding large numbers of older less productive workers, especially when there is a sizeable intergenerational skills difference (Esping-Anderson 1993: 721-722). At the other extreme, social security systems may encourage the deferment of retirement. Many systems, such as the Japanese system, have an incentive structure that increases pension value if retirement is delayed. If contributions are non-transferrable, it is also possible that the promise of future benefits could reduce labour turnover and restrict labour mobility. The evidence on the relationship between pension benefits and labour supply is far from conclusive, though. Barr (1998: 225) cites a study by Mitchell and Fields (1981) who managed to use the same data set in different ways to show that the United States' social-security scheme induces workers to retire earlier, later or leaves the retirement decision unaffected!

Generous sick leave provision may also impact on labour supply, encouraging workers to use allocated sick leave days even when they are not ill. For firms this is costly and may generate production problems. Although acknowledging that "sick pay is the prototypical case of shirking", Esping-Anderson argues that paid sick leave may actually enhance, especially female, labour supply. Because women with small children account for a huge share of total absenteeism, one might argue that paid sick leave enhances women's capacity to harmonise work and family duties so that what at first appears as a work disincentive is in fact a precondition for labour supply (Esping-Anderson 1993: 722).

In general, transfers may induce people to work shorter hours, discourage overtime and the taking-on of a second job. In addition, they may reduce the incentive to seek promotion or put extra effort into one's job. Annual hours worked may fall as people take longer holidays or spend longer between jobs. Over an individual lifetime, too, the total number of hours of labour supplied may fall as people enter the labour force later and retire earlier. Labour supply disincentives are especially pronounced at the lower end of the wage distribution where the difference between average wages and transfer payments is smallest. People earning at this level have the least incentive to increase their labour supply because any wage gains will be substantially offset by reduced benefits. This is the phenomenon of the poverty trap that will be further discussed in section 4.3.1.

This discussion does not assume that a reduction in labour supply is an undesirable consequence *per se*. Indeed, although the provision of social security distorts the choices that people would otherwise make, via a substitution of leisure for labour, this effect need not be negative. For example, living allowances provided to students may encourage further study, aiding human capital formation. A reduction in labour supply is important, as Atkinson (1993: 22) notes, because there is a definite value attached to work. This value is revealed through the income effect. A reduction in labour supply lowers incomes and increases the reliance on benefits by those who have the capacity to work. Over the medium term, some welfare programmes tend to generate a dependency on benefits and sometimes that dependency perpetuates long after the original period of assistance has passed as some people choose to exit the labour market altogether. Attractive benefits and generous eligibility criteria can shift long-term preferences towards greater leisure and less work via a hysteresis effect that is

most visible in those who choose to be long-term unemployed (Blank and Freeman 1994: 31). Another reason to encourage labour force participation arises purely because of the existence of social security programmes: government expenditure on transfers needs to be financed and inducing people to work widens the tax base. Thus, the need to promote work arises partly from the creation of a distorted institutional environment (Atkinson 1993: 22). Paradoxically, although generous social security systems may create incentives to reduce labour supply, they are reliant on a high level of work for their perpetuation.

Through reducing the demand for labour and providing incentives to stay out of employment, it is possible that social security structures create more unemployment and generate welfare dependency. This means that despite the fact that social security systems are “effective instruments to alleviate poverty, they also create poverty in the sense that they ‘prevent’ individuals from engaging in gainful employment” (De Neubourg 1997: 1).

3.2.3. Net Savings, Investment and Economic Growth

It is usually asserted that retirement funds increase the national savings rate. However, this assertion must be carefully qualified. Firstly, any increases in saving can occur only during the build-up of the fund. When workers retire they begin to dissave that which they had built up so that net saving may become zero. If there were to be net saving it would mean that most pensioners were not using up their full pensions and contributions would adjust accordingly.

Secondly, it is disputable whether net saving even occurs in the build-up phase. The amount of net saving depends on the extent to which increases in compulsory saving are offset by reductions in voluntary saving. Substantial net saving does occur if compulsory social insurance does not change voluntary saving behaviour at all. At the other end of the spectrum is the possibility that voluntary saving is reduced by the same amount as compulsory insurance increases, resulting in zero net gains in saving. Naturally, if many people were not voluntarily saving sufficient amounts to finance their old age, a mandatory contributory pension would increase overall saving.

The extent to which voluntary saving is offset is influenced by the generosity of social assistance schemes. The knowledge that there is a safety net to assist one in times of need may discourage households from building up personal savings, or contributing to social insurance funds, as a buffer against contingencies.

Increased savings are considered desirable because they are assumed to translate via increased investment into greater output and economic growth. Although this is standard economic theory, it is debatable to what extent this mechanism operates in practice. In the first place, pension savings are not always used to finance new investment and may, instead, be used to purchase existing assets such as property or to hedge against inflation through the purchase of antiques. In addition, it is not clear whether private or public pension funds yield greater returns on the investment of pension monies.

Under certain conditions social security encourages macroeconomic stability by stimulating aggregate demand. Unemployment insurance, for example, is an

automatic stabiliser (Van der Merwe 1996: 51). In times of recession, unemployment increases and more unemployment benefits are paid out to increase the income of the unemployed. It must be made clear, however, that this effect is a consequence of unemployment insurance and should not be used as a justification for generous unemployment benefits.

The relationship between economic performance and social assistance is problematic; there exists an inherent “crisis” (Van der Merwe 1996: 51) in social security systems funded from general revenue. During recessionary times, when unemployment rises and more people qualify in terms of the means test, social security expenditure must increase. However, this is precisely the time when government has a smaller income. This makes it very difficult to avoid a rising budget deficit.

The high tax rates needed to finance social transfers may also result in considerable investment opportunity costs and dead-weight losses. Assistance programmes may divert capital from other more fruitful alternative investments, which is of particular concern if these investments have high multipliers or job creation potential. It can be argued that the trickle-down effect of such investments could be of more value to recipients of welfare, through improved employment prospects and higher per capita GDP, than social security benefits.

3.3 Administrative Feasibility

The previous section revealed that social security systems may introduce some inefficiencies into the economy. The nature of these distortions is to impede labour market flexibility, distort labour demand and supply incentives, and slow economic

growth, investment and net savings. The extent of these distortions depends on a number of factors, one of which is the administration of the system.

Administrative feasibility requires that the system be simple, easy to understand and cheap to administer. This applies right from the structure of benefits through to the evaluation of applications and the distribution of grants. It also requires that there is as little room as possible for abuse and corruption. Any administrative costs represent dead-weight losses and absorb resources that could be used for more productive ends (Okun 1975: 96). “While both the positive and negative consequences (of social security systems) are positively related to the comprehensiveness, generosity and accessibility of the system, only negative effects are generated if the system is, in addition, loosely administered or open-ended” (Haveman 1996: 6). Important aspects of administrative feasibility, such as the targeting of benefits and the administration of the means test, will be elaborated upon in section 4 of this chapter.

3.4 In Defence of Social Security

The proponents of generous social security systems have refuted the strong arguments put forward by those who highlight the economic inefficiencies caused by social security systems.

Their first rebuttal, and perhaps the most obvious one, is that the economic case against social protection tends to emphasise the social welfare losses that arise from distortionary incentives while ignoring the welfare gains. In addition to the positive effects arising from the alleviation of poverty and income redistribution, a complete cost-benefit analysis should include the economic gains from increased income

security and employment. Such an analysis would highlight the fact that social security can promote economic efficiency. For example, the income security provided by transfers may enhance labour mobility between locations, firms and sectors, as well as encourage innovation and entrepreneurship. In this way it would not only be compatible with labour market flexibility, but also promote it. Social security can develop human capital and labour productivity through child allowances or study allowances, thus stimulating positive behaviour that might not have occurred in the private market. Social insurance programmes can even enhance long-term employer-employee relationships and the productivity yield of training investments in employees (Haveman 1996: 6). Indeed, some proponents of social protection place so much emphasis on its role in enhancing human capital and productivity in the labour market, that they deny the premise of a trade-off altogether.

Other writers make the point that the short-coming of standard models of the distortionary costs of social security are derived from the assumption of perfectly competitive markets operating in a first-best model of economic equilibrium. Institutions such as social security arrangements are seen as market distortions and impediments to adaptability in an ideal world without existing institutions and distortions (De Neubourg 1997: 120-121). The reality is that economic and social interactions take place in a second-best world in which other distortions already exist due to taxation and regulation, for example. In such a world it is impossible to determine to what extent generous social security provisions are to blame for any distortions that exist. Also, a coherent social security system's different component programmes can be designed so as to offset the inefficiencies and distortions caused

by each other. In fact, social security aims to alleviate some of the market failures already present and can mitigate the negative effects of existing distortions.

Related to this last point, a final defence is the reminder that the need for social protection first arose because of the inadequacies of the market in supplying certain social goods. Essentially, the rationale for government intervention in the social security arena arises because of two specific types of market failure, distinguished by Dilnot and Walker (1989: 5-6). Firstly, there is the failure of the market to ensure a socially optimal distribution of income. This can be taken to include a failure to attain the four objectives discussed at the outset of this chapter. A socially desirable income distribution is considered a public good, justifying state intervention in the form of social security transfers (Dilnot and Walker 1989: 5-6). The second market failure occurs on the insurance market. Social insurance only exists because the market, due to moral hazards, externalities and information asymmetries, fails to provide insurance efficiently (Blank and Freeman 1994: 32). This latter rationale for social security will be discussed in considerable detail in Chapter 2

4. Targeting

The objectives of social security systems can only be achieved if the government can accurately determine who should receive benefits and ensure that only these individuals receive them. Fiscal constraints require that the most efficient use be made of social and economic resources, which means that benefits must be carefully directed at the poor. Targeting refers to the different approaches used by governments to do this. The challenge of targeting is succinctly expressed by Cantillon, Marx and Van den Bosch (1996: 25): “The challenge for every country is to find a balance on

the universalist-selectivity dimension that is optimal from a social, an economic and a budgetary perspective". Universal benefits may ensure that the programme reaches all of the poor, but they may be fiscally unsustainable and perpetuate existing inequalities. Greater selectivity may imply more redistribution and increased affordability, but simultaneously introduce dependency and poverty traps, increase perverse behavioural incentives and, most obviously, threaten poverty reduction goals.

4.1 Horizontal and Vertical Efficiency in Targeting

An indication of how well a transfer is targeted is provided by the extent to which benefits are taken up by (and only by) the people for whom the benefit is designed, and the consequent effect on poverty or inequality. The challenge is to maximise the number of the target population that receives benefits whilst minimising the number of the non-target population that receives benefits. Such an optimisation exercise is extremely delicate and the social safety net is often cast too widely or too narrowly. It is then that one of the "two errors of targeting" (Cornia and Stewart 1995: 351) may arise. Firstly, there are errors of exclusion (called Type I errors in statistical analysis) which represent a failure to reach all of the target population. Then, there are errors of inclusion (Type II errors) which occur when there is excessive coverage of the population, i.e. when benefits reach members of the non-target population.

Errors of inclusion and exclusion can be related to the concepts of horizontal and vertical efficiency. Vertical efficiency refers to "the accuracy of the program in assisting *only* the 'target' group" while horizontal efficiency is concerned with "the comprehensiveness of the program in assisting *all* of that group" (Weisbrod 1970,

cited in Atkinson 1995: 30). Thus, errors of inclusion are indicative of vertical inefficiency, while errors of exclusion are associated with horizontal inefficiency.

Horizontal inefficiency in social security is revealed by a low take-up rate of benefits. There can be a number of reasons for a low take-up rate, both on the demand side and the supply side:

a) On the demand side:

- A lack of awareness of the entitlement to benefits – for example, when insufficient effort is made to inform people of their right to benefits, when potential beneficiaries are largely illiterate or where people do not have easy access to communications, media or welfare offices.
- Inconvenience – this factor refers to the cost to the individual of applying for and obtaining benefits, e.g. filling in forms and travelling to the centres where benefits are distributed.
- Opportunity cost of applying for benefits - such as the time lost that could otherwise have been spent on productive or reproductive (domestic) activities.
- Stigma attached to the receipt of benefits is another factor - fear of being branded as part of a particular social group in systems where benefits are seen as “a special benefaction for those who cannot fend for themselves” and “would tend to have some effects on their self-respect as well as on the self-respect accorded them by others” (Sen 1995: 13).

b) On the supply side: On the supply side, the eligibility rules may not be clear enough. Awards may be made at the discretion of the administrator and different regions may vary in their interpretation of the eligibility criteria and their awareness

of certain entitlements. It is also possible that systematic discrimination may arise in the enforcement of these criteria.

Vertical efficiency concerns the extent to which benefits reach only those who need them. In other words, the extent to which leakage to the non-poor is eliminated. Probably the most common source of vertical inefficiency is inappropriately designed benefit programmes. In other words, the eligibility criteria are so structured that they include a number of the non-poor. Vertical inefficiencies may also arise due to moral hazard. When the administration of benefit schemes is not tightly controlled, people who do not satisfy the eligibility criteria may fraudulently claim benefits. However, too strict a policing system is also likely to give rise to targeting errors. As Sen points out:

“Given the asymmetry of information, it is not possible to eliminate cheating without putting some of the honest beneficiaries at considerable risk. In trying to prevent the type II error of including the non-poor among the poor, some type I errors of not including some real poor among the listed poor would undoubtedly occur” (Sen 1995: 12-13).

4.2 Administrative Efficiency

Any system of targeting (except perhaps targeting through self-selection) involves substantial administrative costs. These costs include the financial resources spent on the employment and training of officials, the drafting of targeting policy, documentation and awareness campaigns. Then, there is the expense of evaluating applications and verifying information submitted, especially when a means test is applied (see 3.3.2). Bureaucratic delays in the evaluation of applications are also

costly, to beneficiaries in particular, but also to the state which is sometimes held responsible for paying interest on outstanding benefits.

Another important consideration is the loss of individual privacy and autonomy. Any targeted benefit, whether it uses income or another indicator as the eligibility criterion, requires the disclosure of personal information to welfare officials. Any investigations and policing performed to verify the information disclosed by applicants are at least, equally invasive. In addition there are the social costs of asymmetric power, which reveal themselves in the (intentional or unintentional) intimidation of social assistance applicants by welfare officials, and corruption within welfare departments (see Chapter 7).

Thus, although targeting is often thought of as a device of cost containment, some of these financial gains are off-set by its high administrative costs and negative social costs. Moreover, the more finely-tuned the targeting, the higher are the administrative and so-called “invasive costs” (Sen 1995: 14).

4.3 Targeting Approaches

A number of approaches have been developed by which benefits can be targeted at particular populations according to specific criteria. Firstly, there is targeting via an income test, where the level of benefit received is inversely related to the amount of individual or household income. If wealth or other assets are also taken into account when administering the test, this process is referred to as means testing. The second approach is to use particular indicators of poverty to identify individuals eligible for benefits. With this method, benefits are based on easily observable characteristics that

are highly correlated with poverty. A third approach is self-targeting where incentives to claim benefits are structured in such a way that only those people who are in real need should find it attractive to apply. Finally, there is geographic targeting.

4.3.1 Targeting using the Income Test or Means Test

The means test is the most widely used targeting instrument. More than a method to ensure that grants reach only those in a particular income band, the means test is also a cost-containment device. The stricter the means test, the lower the cost to the fiscus of pension provision. The means test is also influenced by political and moral considerations. For example, where inequalities are very extreme, and largely the legacy of an unjust political past, there may be additional justification for a means-tested social old age pension that effects some redistribution by excluding the relatively well-off.

Targeting via a means test involves setting a particular exclusion level of income (or imputed income). If an applicant's income is below this exclusion level he is eligible for all or some of the benefit. In South Africa, when income increases above a certain minimum level (the disregard or threshold income) – set at 30 per cent of the maximum grant -, the benefit level decreases until no further pensions are paid (at the exclusion or cut-off level). The amount by which the benefit level is reduced for every unit increase in income is termed the claw-back or effective marginal tax rate.

The formula for the calculation of the value of the social old age pension or disability grant is:

$(1.15 \times \text{maximum benefit}) \text{ minus } (0.5 \times \text{private income})$

subject to: a maximum not exceeding the maximum grant

: no grant less than R100 being paid

: no-one with total assets exceeding 30 times the maximum grant receiving any benefit

Means testing, as opposed to pure income testing, requires that an imputed income value is applied to assets so that a more balanced view of an individual's income can be obtained. In South Africa, until 1998, an imputed income value of eight per cent of the value of certain, mainly financial, assets was calculated and added as "deemed income" to other income, but now only actual income from assets is included.

Despite its obvious attractiveness, there are many practical arguments against the means test (Van der Berg 1997: 11-12 and Ardington and Lund 1995: 2). According to Van der Berg it "creates administrative nightmares, encourages concealment of sources of income and may create disincentives to earn income or to provide for retirement" (Van der Berg 1997: 13). These and other difficulties are associated with either the design or the administration of the test.

4.3.1.1 Difficulties with the Design of the Means Test: The Poverty Trap

Perhaps the most serious, and unavoidable, challenge of designing means-tested benefits is that the effective marginal tax rate creates a poverty trap (Le Roux 1991: Sections 1.2 and 2.2; Sephton et al. 1990: Annexure). In other words, the effective

marginal tax rate makes it unattractive for people in a certain income band to earn more private income, as they would lose part of it through a reduced grant. For example, a worker who has made no provision for retirement receives an old age pension of R540. But, a worker who receives an occupational pension of R600 per month in 2000, has his social pension reduced through the means test to R321 ($1.15 \times R540$ minus half of R600). Thus, there is a claw-back or effective marginal tax rate of 50 per cent beyond the first R162 of income. Those earning only a small income in retirement, through informal trading for example, are at risk of falling into the poverty trap. Low-income earners have a serious disincentive to save, continue working, earn more private income or provide for retirement through private or occupational insurance. The structure of the means test for old age pensions also creates incentives to choose lump sum retirement benefits rather than pensions, or to hold assets in a form that is favourably treated by the provisions of the means test.

The extent of the poverty trap effect is not determined solely by the effective marginal tax rate. It is influenced by the length of time over which people face particular marginal tax rates. This time may vary and the effect of the time period is mitigated by several factors.

The regularity with which the means test is applied is an important factor (Barr 1998: 244-247). Usually, the means test is administered on application and then at regular intervals thereafter. For administrative convenience, these intervals may be fairly long, even in developed countries, e.g. six months or one year. This means that during that interval any increase in income will not be assessed by the means test, and will, therefore, not result in any immediate loss in benefits. Thus, in the short term, the

effective marginal rate of taxation is zero. This will counteract the labour supply disincentive of the means test and it will be attractive for a poor person to take on extra employment of a temporary nature, e.g. to work overtime or to work seasonally. Even if the increase in income is permanent the disincentive effect will still be smaller as some temporary benefit would have been gained prior to the next testing. In South Africa, though, despite good intentions to apply the means test regularly, in practice this occurs only every five or ten years and often only once-off. Consequently, the labour supply disincentive is weakened.

Another factor is that the calculation of the means test may change. For example, exclusion levels may change and different assets may be included or excluded. Usually the threshold income for the means test is raised over time and so, not knowing exactly how future assessment will be administered, poor families may be more inclined to take on extra work.

A further consideration is that, when considering labour supply incentives, it is the *perceived* burden of the tax that is important, not simply the objectively calculated marginal tax rate. Thus, one needs to take into account how each individual discounts the future. The more the future is discounted, the lower will be the marginal rate of substitution and the more likely the individual will be to take up employment. It is indeed likely that poor people will discount the future highly because their income is low and there is always a fairly large chance/likelihood that any increase in income may only be temporary.

Consideration of the fixed period of the award of a benefit highlights the economic impact of administrative practices of benefit allocation. There are two main implications: Firstly, it mitigates the poverty trap effect, making it possible for the poor to raise their incomes more easily, lessening the acuteness of the poverty trap. Secondly, labour supply incentives may be improved. In this way, it is also possible to view fixed-period awards as, at least partially, resolving the dilemma faced by public policy analysts in setting the effective marginal rate of taxation at such a level that labour incentives are preserved while the cost-reducing advantages of tightly targeted benefits are still enjoyed. In other words, fixed period awards cushion the impact of high rates of withdrawal, while avoiding the high expenditure of substantially reducing them (Barr 1998: 247).

The debate on the principles, incentives and consequences of the means test and poverty trap, and even the universal pension (see Chapter 3), is a discussion that is relevant not only to social old age pensions, but also to disability grants and the child support grant.

4.3.1.2 Difficulties with the Administration of the Means Test

Regardless of how well a means test is designed, substantial problems can still arise in its administration. Although since 1996, the same means test is now uniformly applied across all regions, the efficiency with which it is administered still varies.

a) Assessment of income: The first difficulty is to accurately assess the income of the applicant. This is especially complicated in the South African context where so much

income is irregular, fluctuating, seasonal or derived from informal sector activities. Local price fluctuations must be taken into account. Furthermore, it may be difficult to impute an individual income value for land and other assets, e.g. when land, housing or cattle are communally owned. In cases where no formal income statement or verification of assets can be produced, claims must be confirmed by a person familiar with the applicant such as, in rural areas, a tribal leader who must accompany the applicant to the welfare office.

b) *Capacity to apply*: The difficult socio-economic position in which many South Africans find themselves hinders their capacity to access grants. Low levels of literacy, numeracy and poor access to transport and communications mean that, for most people, the application process is a difficult, time-consuming and expensive one. Moreover, illiterate people are unlikely to have their lives accurately recorded in terms of assets, income, investments, employment or taxation. They also may lack the numerical skills necessary to determine their own eligibility and thus may not be aware that they are entitled to benefits.

c) *Documentation*: The vast amount of documentation required for applications does not improve the situation. Employees of welfare offices are under strict instruction that application forms are not to be completed unless all the required documents have been submitted (Department of Welfare 1999). For example, application for old age pensions and disability grants must be accompanied by the following documentation: the identification number of the applicant and, if applicable, those of his spouse and children, proof of marital status, proof of income and assets, bank statements for three consecutive months, proof of employment or unemployment, proof of how lump-sum

assistance was spent, information on dividends earned on investment and, in the case of disability grants, a medical report (Department of Welfare 1999). This amount of documentation is substantial and often difficult to obtain, so it is understandable that provinces enforce this requirement with varying degrees of rigidity. Proof of eligibility is essential for accurate targeting, but consideration certainly needs to be given to how difficult it is for people to prove their eligibility.

Thus, there are many difficulties associated specifically with the administration of the means test, in addition to the difficulties associated with targeting in general (see 4.1-4.2). Some of these involve substantial costs to the state - it requires an enormous and expensive bureaucratic structure to collect and process applications – while others involve costs to the individual. Interestingly, Atkinson points out that it may be precisely these obstacles that constitute the most accurate targeting device as they “serve a sorting function” (Atkinson 1995:58) - a way of screening applicants so that only the truly poor would find it worthwhile to apply. However, such a view seriously underestimates the opportunity costs of the time of the poor and serves to promote the stigmatising and invasive targeting methods that were characteristic of early social security schemes. Of most concern is that, as a consequence of these obstacles, substantial numbers of eligible people may be excluded from receiving benefits. Thus, the legal and bureaucratic complexity of means testing can work to “the disadvantage of the least advantaged” (Cantillon, Marx and Van den Bosch 1996: 27). The financial savings (and political gains) generated by targeting need to be carefully weighed against these costs. If the costs of targeting prove very high, there may be merit in considering a universal benefit (see, for example, the discussion on a universal pension in Chapter 3).

4.3.2 Indicator targeting

This approach directs benefits at poor individuals or households by using some directly observable characteristic that they have in common. Examples of appropriate indicators include the gender of the household head, age, land ownership, nutritional status and nutritional risk. In order to enhance horizontal efficiency the characteristic should be highly correlated with poverty so that the maximum number of the target population can be identified by this criterion and the minimum number left out. Accurate indicator targeting should also maximise vertical efficiency, meaning that this particular characteristic should not be exhibited by many of the non-poor. Sometimes this requires the use of indicator targeting in conjunction with means testing. For example, single parenthood is highly correlated with poverty, but as there are also some relatively wealthy single parents, benefits exclusively for single parents may be subject to an income test as well. Furthermore, the chosen indicator should be of such a nature that it can not easily be manipulated. In other words, incentives or opportunities to change one's status or behaviour in order to qualify for benefits should be minimised. In practice, such an indicator is very difficult to find. A final desirable trait of the indicator is that it should be easy to observe so that administration costs are minimised.

A major advantage of pure indicator targeting over income testing is that the disincentives to withdraw from employment are weaker as only the income effect works against labour supply. Regardless of how much an individual earns, the fact that he belongs to the indicated group qualifies him for a benefit. The reliance of indicator targeting on easily observable traits can significantly simplify

administration. Nonetheless, it is clearly impossible to generalise the characteristics of the poor so that a system based on indicator targeting includes every poor person.

4.3.3 Self-targeting

This is an administratively simple approach that builds an incentive system that is so structured that only targeted individuals will respond to the incentives. Choice is the key signaling device and applicants, through their personal choices, self-select themselves for benefits. A popular method of self-targeting is to introduce price subsidies on products and services consumed disproportionately by the poor (Burgess and Stern 1991: 64), i.e. on products that have a negative income elasticity of demand. Usually, such goods have higher-quality higher-priced substitutes that tend to be consumed more by the non-poor. Another method is to use so-called conditional benefits (Barr 1998: 239). This method relies on the assumption that the benefit offered is of such a nature that only the truly poor will come forward to claim it. The most obvious example is work-fare where low-paid employment is offered to unemployed people.

Some authorities consider this more effective than cash benefits in reaching the poor because it prevents recipients of benefits from continuing to work unofficially while receiving benefits and reduces the chance that benefits may be used to subsidise leisure. Nevertheless, this type of targeting is far from ideal. In the case of work-fare, for example, gaps in targeting might arise where some genuinely poor people are physically unable to work and it also may crowd out some wage work. This approach has been criticised for treating beneficiaries in an undignified manner – providing

subsidies for lower quality products and work for low pay. Human dignity may be the price of cost-containment.

4.3.4 Geographic Targeting

Another option is geographic targeting. The process of geographic targeting allocates benefits to all people living in a defined geographic area. It is used in areas where the poverty rate is so high that the cost of administering the means test is considered higher than the additional cost of providing benefits to non-poor residents. This would be an attractive option in certain parts of South Africa, particularly in rural areas where the incidence of poverty is highest. The number of errors of inclusion (Type II errors) would be relatively low and errors of exclusion (Type I errors) would be virtually eliminated. It would certainly simplify the administration of benefits and may save costs as the means test would not have to be applied.

5. Conclusion

In the pursuit of their objectives, social security systems introduce a number of distortions into the economic system. The contribution and benefit structure can induce people to act differently, in particular it may create incentives to alter labour supply and demand. Labour market flexibility may be impeded and savings and investment retarded, to the detriment of economic growth. The different targeting techniques have high administrative costs, can introduce unwanted incentives into the system and may have undesirable economic effects. Moreover, the more generous a social security system is, the stronger these negative effects. This eventually begs the

question: at what point is the system too generous? At what point have we traded too much efficiency for increased equality?

Arthur Okun's (1975: 91-100) "leaky bucket experiment" has often been cited to highlight these, sometimes hidden, economic costs of transfer programmes. Okun explains that "the (transfer) programme has an unsolved technological problem: the money must be carried to the poor in a leaky bucket. Some of it will simply disappear in transit, so the poor will not receive all the money taken from the rich" (Okun 1975: 91-92). This leak is an inefficiency representing "administrative costs, reduced or misplaced work effort, distorted saving and investment behaviour, and possible changes in socio-economic attitudes" (Okun 1975: 96). However, these leaks or inefficiencies must be balanced against the social benefits derived from the programme, in terms of income redistribution, poverty alleviation and even productivity enhancement. Thus, in evaluating a social security system, the critical choice is to decide what level of inefficiency is tolerable. This will be informed not only by the objective severity of the leak, i.e. the types, range and size of inefficiencies that arise. It will also most crucially depend on what sort of leakage society and policy-makers are prepared to tolerate. This, in turn, depends on equity considerations; on how important social security objectives are relative to other priorities. Therefore, the generosity of a social security system emerges from the political process rather than only from a cost-benefit analysis of outcomes, which themselves, as has been shown, are far from clear. As "the conflict between equality and economic inefficiency is inescapable" (Okun 1975: 120), each social security regime must decide where it stands.

PART ONE

CONTRIBUTORY SOCIAL INSURANCE

Throughout history, the reduction of economic insecurity and risk has been a driving force behind the development of social, political and economic institutions, ranging from the feudal system, tribal land tenure systems and the extended family through to modern social security. The major contingencies that modern social security has to protect against are loss of income or earning power through old age, illness, disability, or unemployment – the very same contingencies that the Bismarckian welfare state with its social insurance and social assistance components evolved to protect.

Reducing risk to tolerable levels also affects people's preparedness to take welfare-enhancing risks such as engaging in entrepreneurial activity. It is thus important for the vibrancy of an economy that risk-reducing institutions such as social insurance work effectively and appropriately.

The two parts of the modern social security system are social insurance and social assistance. What distinguishes social insurance from social assistance is that under the former protection against life contingencies is provided as a form of insurance, paid from funds contributed by employees and employers (or road users in the case of the Road Accident Fund). Because risk pooling is the principle by which insurance works, it makes little demand on the state, except as an employer, to fund such insurance. However, in the case of social assistance, the full cost of provision rests on the state and benefits are funded from general revenue. In the case of social insurance,

the costs of risk reduction are borne by workers and employers with the result that it has a similar effect to a tax on labour. This effect was discussed in Chapter 1.

The social aspect of social insurance derives from the fact that such contributions are usually compulsory and organised by the state. In South Africa, though, as is revealed in this thesis, a combination of negotiated benefits and norms in certain industries and sectors have resulted in occupational insurance becoming *de facto* social insurance. The term social insurance is thus not strictly accurate to describe the South African system, as there is no legal compulsion to contribute, but as most contributors have little option whether to contribute or not, this legal distinction has little practical relevance.

South Africa has four main forms of social insurance:

- occupational pensions provide insurance against the risk of income loss in old age
- workers' compensation insures against the risk of income loss through disablement
- unemployment insurance tries to insure against the risk of job loss
- the Road Accident Fund compensates victims of road accidents for medical expenses and a loss of earnings.

Although comparable figures are not always available, the size of the social insurance industry can be gauged by the fact that in the mid-1990's about R20 billion was paid out annually in social insurance benefits, most of which was spent on occupational pensions (about R17 billion), followed by unemployment insurance payments of over R2 billion, and disability compensation of slightly more than R500 million. Almost all these funds were generated by employers and employees alone, without state

assistance. This is compared to about R14 billion paid out in the form of social assistance and funded from general government revenue.

Chapter 2 will examine the operation of the insurance mechanism and the rationale for the public provision of certain types of insurance. Then, occupational pensions (Chapter 3), unemployment insurance (Chapter 4), and insurance against disease and disability sustained in the workplace (Chapter 5) will be examined². Part One will close with a look at the insurance provided to road users by the Road Accident Fund in Chapter 6.

² These three chapters draw substantially on a background paper written with Servaas van der Berg for the Social Policy Project of the Centre for Development Enterprise entitled “Social Insurance in South Africa (excluding Health Insurance)” (1998).

CHAPTER 2

A THEORETICAL PERSPECTIVE ON SOCIAL INSURANCE³

1. Introduction

As opposed to social assistance which seeks to provide a safety net, a minimum income, to the poor and marginalised, social insurance strives to fulfil the need for income maintenance in the face of unexpected contingencies. Through regular and predictable contributions, from employers and employees, individuals insure themselves against potential variations in their income stream. Social insurance, thus, only provides protection to the employed who, in South Africa, find themselves in the middle or upper parts of the income distribution.

The theoretical justification for social insurance arises from the failure of the private insurance market to provide the optimal quantity of insurance. Consequently, an analysis of the mechanism of social insurance must necessarily be preceded by an examination of the private insurance market. The following discussion of the demand and supply of insurance in private markets will reveal why certain types of insurance are not provided by the market and why, even in cases where the market does provide, the state still deems it desirable to intervene.

In the course of this analysis it will be revealed that there are three conditions that must be met if insurance is to be provided by private markets:

³ This chapter draws on the analyses of Nicholas Barr in Chapter 6 of *The Economics of the Welfare State* (1998: 108-128) for much of the theoretical background.

- a) There must be a positive demand for insurance
- b) The information problems of adverse selection and moral hazard must be able to be efficiently overcome, and
- c) Insurance must be supplied at a price that the consumer is willing to pay.

If these conditions are not met, then social insurance may, under particular circumstances, provide a more efficient solution.

2. The Individual Demand for Insurance

The first question that needs to be asked is why, in the initial instance, there is a need for insurance, regardless of whether it is provided in the private or public sphere. This can be reformulated as a question examining the individual demand for insurance. The key underlying assumption is that the individual is risk averse. Thus, he will prefer to pay regular premiums in exchange for the certainty of a particular income, if the insured event should occur, rather than face an uncertain future income stream. He will do this, even though he knows that the insured event may never arise or that, if it does, the insurance pay-out may be less than his combined premium payments. In more formal terms, the demand for insurance derives from the assumption that individuals maximise expected utility under uncertainty (Culyer 1980: 41).

The algebraic analysis proceeds as follows (Barr 1998: 109):

In a world of uncertainty, an individual's expected future income stream is not constant, but fluctuates as negative or positive eventualities arise. Simply stated, it is the sum of his income during "good times" (i.e. times of employment and good health) and his income in "bad times" (i.e. times of unemployment or ill health),

multiplied by the probability of having “good times” and “bad times”. Algebraically, this relationship is expressed as:

$$E(y) = p_1y_1 + p_2y_2 \quad (1)$$

Thus, his expected utility, derived from income, would be:

$$E(U) = p_1U(y_1) + p_2U(y_2) \quad (2)$$

In the latter expression, utility is obtained from the expected utility of the uncertain income y_1 or y_2 . It is clear that over time the individual receives an expected or average income of $p_1y_1 + p_2y_2$, and, thus, derives an expected utility of $p_1U(y_1) + p_2U(y_2)$.

However, the same utility could be obtained from a lower, but certain income y^* , that can be obtained through paying insurance premiums. Because a rational individual is risk-averse, uncertainty *per se* is a source of disutility and, thus, he will be prepared to pay a price (premium) to secure certainty. He would be indifferent between an expected income $p_1y_1 + p_2y_2$ arising from uncertain incomes and a lower income y^* with certainty. Thus, the value of certainty (V) is the difference between the expected income and the lower income with certainty:

$$V = (p_1y_1 + p_2y_2) - y^* \quad (3)$$

It follows, then, that a rational individual will be prepared to pay a net price X provided that the premium is less than the value he attaches to certainty:

$$X < V \quad (4)$$

It is important to note that X does not represent the gross premium paid by the individual on a regular basis. Rather, it is the net premium which is the difference between the gross premium (G) and the average pay-out to the individual from the insurance company, the latter being a product of the size of the loss (L) and the probability that it will occur⁴. In other words the net price of insurance is:

$$X = G - pL \quad (5)$$

3. The Nature of the Insurance Mechanism

The fundamental mechanism by which insurance operates is that of risk-pooling. Although individuals may face uncertainty, society as a whole can face approximate certainty. Thus, because the average societal risk is known, premiums can be set according to the average risk so that those who suffer the eventuality can be compensated by the contributions of all. Thus, the risk is shared and certainty increased and utility enhanced.

Retirement insurance, in the form of annuities, is the classic example of risk-pooling. If an individual takes a lump-sum pension, he is responsible for distributing this

income over his old age, but runs the risk that he will outlive his pension. As a rational risk-averse individual, he will probably prefer to convert his pension into a retirement annuity that guarantees a specified monthly income for the rest of his life. If he lives very long he may even receive more money than the initial value of his pension. This is made possible through the pooling of risk, based on average life expectancy: other people may not live long enough to use their full pensions.

The size of the retirement annuity is a function of the value of the lump sum (A), the insurance company's opinion of the applicant's life expectancy (n) and the expected real interest rate (r).

$$y = g(A, n, r) \quad (6)$$

The annuity is inversely related to the life expectancy of the population or risk group to which the individual belongs (determined by factors such as age, sex and health), and directly related to the real rate of interest, defined as the excess of the nominal interest rate over the inflation rate.

In order for risk-pooling to operate effectively, two criteria must be met: Firstly, all individuals must face the same probability distribution of future income, and, secondly, each individual's expected income and probable variance from it must be independent of that of others. It is when these conditions are not met that the

⁴ As will be seen shortly, the gross premium also includes a factor to cover the firm's administrative costs.

insurance principle breaks down and the private market fails to provide insurance.

This will be more closely examined in section 4.1 of this chapter

4. The Supply of Insurance

An analysis of the supply side of the insurance market considers under what conditions firms will be induced to offer insurance on the private market, how much insurance and at what price.

The gross insurance premium (G) that a firm will demand from a client is determined by the individual's expected loss. The expected loss is itself a function of the probability of the loss (p) and the value of the loss, plus a factor to cover the firm's administrative costs. Thus, the gross insurance premium, or the price of insurance in a competitive market, is given by

$$G = (1+\alpha)pL$$

However, certain condition must be met if insurance is going to be supplied efficiently by the private market.

4.1 The Challenge of Estimating Probability

The first set of conditions relates to the necessity of being able to estimate probabilities in order to pool risk. First, all individuals must face the same random probability distribution of future incomes. Problems arise when differences exist between members so that some are more prone to the insured event than others. For

example, living in a crime-ridden neighbourhood predisposes one to burglaries and, thus, more (household) insurance claims. For this reason it is argued that although the efficient price of insurance should not reflect random differences in probabilities, it is necessary that systematic differences are uncovered and high risk and low risk individuals pay different premiums. Secondly, each individual's expected income and probable variance from it must be independent of that of every other individual. In other words, the risk/probability of the insured event arising for one particular individual must be independent of the probability for anyone else. If not, the mechanism of risk-pooling ceases to operate effectively and members become vulnerable to common (covariate) shocks. This is why, for example, most travel insurance companies refuse to insure against *force majeure*. It is also one of the reasons why it is so difficult, if not impossible, to obtain private unemployment insurance - this will be further discussed in Chapter 4.

Another precondition for insurance to be provided by the private market is that the probability of the insured event arising must be less than one. If it is equal to one, then there is a one hundred percent probability that the event will occur and premiums would have to be set higher than the expected loss (to also cover administrative costs), thus eliminating demand. This last condition offers an explanation as to why private market medical insurance policies generally exclude coverage for pre-existing conditions.

Risks must also be known, i.e. it must be possible to calculate the probability of the contingency arising. Insurance cannot provide for certainty, i.e. when probability is equal to one. Nor can it cope with uncertainty, i.e. when the probability of the event

occurring can not be calculated and, therefore, an appropriate premium can not be set. As an example, it is only when the average life expectancy for a group is known (certain) that individual retirement premiums can be calculated. The example of old age insurance can be used to illustrate another problem of estimating probability, namely, that probabilities that are known in the near future may become unknown in the long run. The probability distribution of price changes in the long-term future is extremely difficult to estimate, for example, and so certain insurance products and financing mechanisms may not be able to protect retirement pensions against erosion by inflation. This issue will be examined in more detail in Chapter 3.

Thus, if the private market is to provide insurance, the probability of the insured event occurring must be known and less than one, while risks must be non-systematic and independent of each other. But, the challenges faced by the private market in providing insurance are not limited to the difficulties of estimating probability. It is further compounded by market failures. Of particular importance are those problems related to asymmetric information, namely adverse selection and moral hazard, and it is these that will be examined in the following section.

4.2 The Problem of Assymmetric Information

This market failure implies a violation of the assumption of perfect information - considered a precondition for the provision of insurance on the private market. Asymmetric information exists when the information required to provide insurance at optimal market-clearing prices and quantities is not shared by buyers and sellers. It can manifest itself in two ways: either through hidden knowledge, whereby the buyer of insurance can conceal from the seller how risky a client he is, or through hidden

actions where the buyer can influence the occurrence of the insured event or the size of the risk. The former is referred to as adverse selection and the latter as moral hazard.

4.2.1 Adverse Selection

The term adverse selection implies that if private insurance is voluntary it will tend to attract a disproportionate number of high risk buyers. The greater an individual's uncertainty regarding his future income stream, the greater will be his demand for insurance. This in itself is not a problem for the private market, though. Provided that the insurance provider can accurately calculate the individual's risk, potential loss, and, thus, premium, insurance can be provided. The problem arises when the potential buyer can conceal a high level of risk from the insurance provider. The insurance firm, then, miscalculates the individual's risk (probability) and the size of the potential pay-out, and premiums will be set at too low a level. For example, applicants for private health insurance may deny a previous incidence of disease or unhealthy habits in order to avoid the higher premiums associated with poorer risk categories. As a result the probability distribution is distorted so that average risk is greater than the original actuarial estimate. The insurance provider is likely to pay out more than he receives in premiums.

To combat the hazard of adverse selection, private insurance companies have developed a number of responses. They may choose to charge a premium based on average risk. This avoids the difficulties of accurately establishing individual risk. However, micro-economic analysis reveals that this is less efficient than individually-

tailored policies (Barr 1998) and there exists the possibility that other companies will attract the lower risk group by offering lower premiums⁵. The latter phenomenon is known as cream-skimming or cherry-picking. Because the best risks are skimmed off by the firms offering lower premiums, the average risk of those remaining in the original pool is higher and their premiums become more expensive. This can have unfortunate consequences for high risk individuals who, unable to afford the higher premiums of their insurance packages, are often left uncovered – reliant on social assistance transfers, family remittances or the charity of the community. State intervention could solve this problem by making membership compulsory so that low risks are prevented from opting out of the pool.

A common practice to combat adverse selection is for insurance companies to screen potential members more thoroughly, for example by demanding copies of clients' medical records in the case of health insurance, to more accurately establish their risk. There is also the possibility of raising the premiums of all contributors to protect against the eventuality that some individuals will provide false information – provided, of course, that there is still a demand for insurance at that price. Yet another solution is to appeal to self-selection of particular clients by structuring the contents, coverage and conditions of the policies in such a way that they are attractive to particular risk categories. In this way, potential contributors will buy insurance products that match their risk, revealing through their consumer behaviour their true probability. For example, a health insurance package only covering emergency treatment, limited medicinal treatments and the occasional physician visit will only attract relatively healthy low risk members.

⁵ For a graphical analysis see Barr (1998: 115-117).

The problems of adverse selection highlight once again the importance of setting premiums to exactly match individual risk. If actuarial estimates are to be accurate, individual probabilities must be known. On the other hand, if risk-pooling operates properly and reliable estimates of the group risk can be made, knowledge of individual risk is not necessary – provided that there are only random differences in individual probabilities. If systematic differences emerge, compulsory insurance may be necessary to facilitate “bringing in the magic of averages to the aid of the millions” (Winston Churchill, quoted in Flora and Heidenheimer 1984: 19).

4.2.2 Moral Hazard

The other dimension to the asymmetric information problem is that of moral hazard. An actuarial insurance scheme requires that risk be known, i.e. that insurance firms be able to estimate the probability and potential size of claims. Such estimations require that the probability of the risk is exogenous: the insured individual can not influence the probability of the event occurring or the size of the loss. In reality, however, this is not always the case. Indeed, individuals have an incentive to influence the occurrence of the event if the expected gain from the claim is higher than their private costs of inducing the event. But even if there is no incentive to encourage an event, there is certainly little incentive to take steps to avoid its occurrence: the main beneficiaries would be the other members who might face slightly lower premiums. Thus, there exists an incentive to under-invest in preventative activities.

The strength of this incentive depends on the psychic costs associated with the event. It is almost always possible to influence the occurrence of an insured event, e.g. by

skiing into a tree, setting one's house on fire or even committing suicide. However, in these cases, the psychic cost of the event is so high that it is unlikely that someone would do it voluntarily, purely for financial gain. Yet, if the psychic cost is not very high, there could be an incentive to encourage the event, or, at least, to take fewer preventative steps against it. One could argue, for example, that the psychic cost of car theft, for example is not high enough to warrant the installation of a vehicle immobiliser. Some events may even have substantial associated psychic gains that provide a clear incentive for the individual to influence the occurrence of the event. For example, someone covered by health insurance may opt for elective cosmetic surgery that he might otherwise have considered too expensive. For this reason, most private insurance policies state explicitly what expenses are not covered by the insurance package. Finally, there is the case where the claimant can influence the size of the claim. Examples include prolonging a hospital stay (in the case of health insurance) or claiming compensation to a greater value than the actual theft (in the case of household insurance). This is known as the third-party-payment problem. As a result of the divergence between the private cost (to the member) and social cost of claims compensation, the consumption of health care or motor vehicle repairs is inefficiently large and premiums are chased upwards.

In all of the above-mentioned cases, the insurance market fails because the member is able to influence either the probability of the event or the size of the claim.

Although it can never fully overcome the problem of moral hazard, private insurance has developed different ways to deal with it. One solution is for an assessor to inspect damage claims so that only the true insured loss is compensated for. Another option is

to shift some of the costs of claims from the insurance provider to the member: some policies demand that frequent claimants pay higher premiums, others hold the insured person responsible for the first part of any claim, and still others are coinsurance schemes whereby the member always pays a fixed per cent of any claim.

Thus it can be seen that despite the problems of imperfect information (adverse selection and moral hazard), it is still possible for the private market to provide insurance in most cases. There are, however, some cases where this is not so; where the private insurance mechanism breaks down to such an extent that private insurance is no longer possible and the state intervenes to provide social insurance:

- a) When consumers are imperfectly informed: consumers may not fully understand the technical details of contracts and may be generally uninformed of or unable to predict the exact type of cover they will need in the future. In some cases, the market may provide the necessary information, for example through insurance brokers. But, the information problems can never be totally alleviated, and if information problems are large, the competitive private insurance is inefficient, and may even create inequities, for example, when people are sold inappropriate pension policies.
- b) When insurers are imperfectly informed: The problems of moral hazard and adverse selection, and the resultant cream-skimming, gaps in coverage and third-party incentives for over-consumption have already been discussed.
- c) High administration costs: The supply of private insurance entails many unavoidable administrative costs such as marketing costs, processing of applications and reimbursement costs. If these costs are too high, risk-averse

individuals may consider insurance too expensive to buy⁶. This can be solved by subsidising or regulating the price of private insurance.

It is in these cases that the demand for social insurance, for reasons of efficiency, arises.

5. The Need for Social Insurance

Arguments for the provision of social insurance are made on the grounds of both efficiency and equity.

5.1 Efficiency Arguments

Efficiency arguments for social insurance are based on technical (information) failures on the supply side and the need for longer term policies on the demand side. The preceding section focused on private insurance markets and implied that the need for social insurance arises because of the failure of the private market to provide an optimal quantity of insurance. However, this is not necessarily a justification for state provision of insurance. It may be sufficient for the state to intervene and legislate compulsory insurance. In this way, some of the factors that lead to market failure can be eliminated, and insurance can still be provided in the private sphere.

⁶ The costs are especially high compared to the lower marketing, processing and reimbursement costs that could be realised with the standardisation and economies of scale of social insurance. However, these potential savings do not arise because social insurance is public rather than private, but because it is compulsory and administered by large funds.

It is important to distinguish between those arguments that justify compulsory membership of insurance schemes and those that justify public provision of insurance.

The first arguments for compulsory insurance stem from the fact that when insurance membership is voluntary, some people (low risks) may choose not to insure themselves. As has already been argued, this threatens the solvency of funds as they become over-burdened with high risks and the pooling mechanism ceases to operate effectively. Compulsory insurance ensures that there are enough low risk members for cross-subsidisation of high risk members by low risk members to occur.

In addition, because an uninsured individual becomes dependent on the state and the community for his maintenance, voluntary insurance imposes a negative externality, both financial and psychic, on society. Thus, another argument for compulsory insurance arises from the fact that the unemployment, illness, disability, old age and work-related injury of one individual imposes costs on others. By legislating compulsory insurance, the state corrects this market distortion.

Another argument for compulsory insurance is that it helps to overcome some of the problems of accurately estimating individual risk. All members contribute a similar premium, regardless of individual risk, so that risks can be pooled and precise actuarial estimates made, thus overcoming the problems of adverse selection. Analytically, the low-risk members pay a lump-sum tax and high-risk groups receive a lump-sum transfer⁷. Compulsory insurance also makes it impossible for low-risk

⁷ The distortionary effects on the economy of a lump-sum tax or transfer are limited.

members to opt out, thus avoiding the escalating premiums and exclusion of high risks that usually accompany this behaviour.

These arguments illustrate that making insurance contributions compulsory can overcome many of the problems associated with the provision of private insurance. The role of the state would simply be to legislate compulsory contributions and monitor the management of the funds. The actual provision of insurance could be left to the private sector.

Still, there are cases where, even if compulsory insurance is legislated, the private market still fails. These are the cases where risks are unknown. Social insurance, in contrast with actuarial cover, can cover not only risk, but also uncertainty. In other words, insurance can be provided even if probabilities cannot be accurately estimated. This is because there need not be an actuarial relationship between benefits and contributions and any deficits can be covered by government funds. Importantly, social insurance is in many ways more flexible than private insurance in that it can adapt to risks that change over time. It avoids the hazard of consumers choosing policies that become inappropriate for their needs later in life; it also enables the policy to be adapted to changing social conditions, such as family structure and medical innovations; and, as will be seen later, it can cope with inflation. Social insurance can deal with uncertainty.

5.2 Equity Arguments

But actuarial and information failures are not the only justification for social insurance. This argument departs from the premise that the events that social

insurance insures against are a social construct and thus require a social response. **For** example, unemployment insurance is only necessary because employment **has** become a binary phenomenon (i.e. one is either in or out of employment) and **the** chief source of income in most countries. Similarly, retirement is a discrete event **that** has been imposed on individuals by legislation. Individual risk is to a large extent **the** result of social policies and, thus, social policy should make provision for **protection** against that risk.

Horizontal equity requires that all individuals have equal access to **certain** commodities of a minimum standard. In theory, this occurs automatically when **there** is perfect information and equal power. If these assumptions do not hold, there is **an** argument for publicly organised insurance on equity as well as efficiency grounds. **As** was shown in section 3 of this chapter, the assumption of perfect information **is** frequently violated (in the forms of moral hazard and adverse selection). **The** assumption of equal power also does not hold as private policies tend to be **very** complex and are less easily understood by the less articulate or poorly-informed.

Barr (1998: 194) provides a justification for state provision on the grounds of **vertical** equity. He argues that poverty imposes a negative consumption externality on **the** relatively wealthy, an externality that can range from a simple psychic disutility **to** increased crime rates, for example. Therefore the rich might want the poor **to** consume insurance as the insurance of the poor increases the utility of the **rich**. Moreover, there may be less stigma attached to receiving insurance benefits **than** welfare transfers.

Social insurance also enhances intergenerational equity. Redistribution over the life-cycle or individual income-smoothing is the main aim of retirement insurance. Those in their economically active years reduce consumption and contribute to retirement funds, but once in retirement they draw benefits. Thus, there tends to be a redistribution from the younger contributors to the older recipients. In a funded scheme, this effect is enhanced by the fact that most pensioners receive more than the sum of their past contributions, in real terms, following the investment of contributions. In a pay-as-you-go scheme, the current older retired generation is supported by the contributions of the current economically active population.

6. The Nature of Social Insurance

Social insurance can take two forms. In the first instance, the contributions can be related to average risk. This is pure risk-pooling and the insurance mechanism operates actuarially, in the same way as in private markets. What is more common, is the second case, to relate contributions and benefits to income. This is done because the objective of social insurance is income maintenance. It is not only the probability of becoming unemployed, for example, that must be considered, but also the size of the income loss that must be compensated for if that eventuality should arise. Those earning higher wages will not necessarily be satisfied with compensation for the average loss of income. Thus, those who stand to receive higher benefits pay higher contributions.

It is necessarily so that the state provides a sub-optimal quantity of insurance because in order to realise economies of scale and minimise administration costs, the insurance packages offered tend to cater to average needs and are not tailored to

individual tastes. Still, as shown earlier, in many respects, it remains more efficient than market provision. In addition, there is always the possibility of private market top-ups to publicly funded policies, e.g. for sickness and disability, for those who demand more elaborate coverage.

The administration of social insurance can be by the state at the central level or at a lower level, such as provinces or local municipalities. Alternatively, administration can be taken care of by private sector institutions such as trade unions.

The principles and mechanisms of social insurance are very different to those of private insurance; so different, in fact, that it can be argued that it should not be termed "insurance". Contributions are not necessarily related to average risk, but may be set at a flat-rate as in the original Beveridge welfare state, or, more commonly, related to the contributor's income, such as in states that follow the Bismarkian model. Membership is usually compulsory.

Entitlement to benefits does not depend solely on the occurrence of the insured event. In some countries the receipt of benefits is contingent on continuous and proven job search and training. Women can also receive unemployment benefits when pregnant.

Also, unlike in the case of private insurance, equity considerations are important when it comes to social insurance. The system as a whole tends to redistribute from rich to poor. This redistribution does not occur only because the poor are more vulnerable to the risks protected against, but because the formulae according to which contributions and benefits are calculated tend to favour the poor. One example is the ceiling

(maximum benefit level) attached to the receipt of some benefits. Another example is that households with many dependants may receive more benefits than smaller households, even though they pay the same contributions.

Another difference between private and social funds is that, in most social systems, provision is not made for future liabilities: current benefits are paid out of current contributions - the pay-as-you-go system. Also, the contract is not fully specified so the nature of the risk that is covered can change over time. The state can withdraw certain benefits previously offered, but can also make provision for unforeseen risks. Thus, the resulting public institutions that provide for social insurance do not look actuarial. They cannot be called insurance providers in the sense that premiums bear an actuarial relationship to individual risk, but are insurance providers in the sense of providing protection against risk; against a loss of income.

7. Conclusion

This chapter has provided the theoretical justification, both from an efficiency and equity angle, for the provision of social insurance. It has also revealed how the insurance mechanism operates and the threats posed to its efficient functioning. The issues raised in this chapter will re-appear in particular manifestations in the subsequent chapters on retirement insurance, unemployment insurance, workmen's compensation and road accident insurance, where they will receive detailed attention.

CHAPTER 3

SOCIAL INSURANCE FOR RETIREMENT

1. Introduction

Few developing countries have as sophisticated an occupational retirement insurance system or as large a social assistance programme for old-age pensioners as South Africa. Rising life expectancy is contributing to a rapid increase in the number of older persons in South Africa (cf. Kinsella & Ferreira 1997), but unlike in developed market economies, ageing has not yet resulted in an inordinate economic burden being borne by a relatively small economically-active population. The elderly are on average somewhat better off than the population as a whole (Mouton Committee 1992:62). The key issue is how to deal with the growing numbers of people who retire with some but limited retirement provision.

Only after the 1956 Pensions Funds Act was passed to regulate retirement funds did occupational retirement insurance widen to include less skilled (mainly black) workers. At the same time economic growth drew many more workers into formal employment. As a result retirement fund membership (including private provision) grew at 7 per cent per annum for three and a half decades, from 923 000 in 1958 to 9 309 000 in 1993 (Smith Committee 1995: D2.4a). Thus, occupational retirement insurance has played a large role in contractual savings, with the 16 000 retirement funds having assets amounting to 73 per cent of GDP in 1993 (Smith Committee 1995: D2.16). In 1992, insurance benefits totaling R17.2 billion were paid out (R3.3 billion of which were resignation and withdrawal benefits), compared to only R4.8 billion paid as social old-age pensions (Smith Committee 1995: D2.1, 2.2, 2.6).

2. A Theoretical Perspective on Insurance for Retirement

Efficiency requires that the individual buys the "socially efficient real level of pension" (Barr 1998: 210). Clearly there is a demand for retirement insurance. In old age, there is a reduction in economic activity and earnings potential; there is a need to protect lifetime savings in the face of inflation; and there is uncertainty as to personal life expectancy. The negative externalities imposed on others, or on the state, by those who do not provide for their old age (discussed in the preceding chapter) also provide an efficiency argument for compulsory retirement insurance. Thus, it is clear why retirement insurance is a desirable good, but it is not clear that the state should supply this insurance.

2.1 The Justification for the Social Provision of Retirement Insurance

As has already been noted, one reason for state intervention in insurance provision is if the private market, for technical reasons, cannot provide the desired quantity of insurance efficiently. However, at first glance, it would appear that the private market should face few difficulties in this regard. The probability of a particular pensioner living to a certain age is independent of that of other pensioners. This probability is known to actuaries because of fairly reliable data on mortality and life expectancy and, provided that enough people are members of a fund, adequate risk-pooling should occur. The problem of adverse selection is small as the individual does not generally know how long he will live and moral hazard poses little threat⁸. The only

⁸ Moral hazard poses little threat except in the case of early retirement, but provision for early retirement can be built into retirement contracts in a way that efficiency is not jeopardised.

efficiency argument for state provision of retirement insurance is that the private market cannot guarantee protection against unanticipated inflation.

The key to private sector failure in this regard is that the probability distribution of different future levels of inflation is unknown. Moreover, inflation is a common shock – in other words, the probability of a particular pensioner experiencing inflation is exactly the same as that of another. Thus, the pooling mechanism breaks down and winners cannot compensate losers. It should be made clear that it is not the provision of pensions in general that poses a challenge to the private market, but the provision of pensions that are not significantly eroded by inflation. The degree to which different insurance funds manage to protect pensions against the ravages of inflation depends on how they are financed and whether inflation is experienced predominantly in the build-up of the fund or while pensions are in payment. This will be examined in detail in the next section.

Arguments for the social provision of retirement insurance on equity grounds have not received much theoretical support. The most common argument used is that the state should provide pensions because the poor would otherwise not be able to afford them. But this argument confuses the **objective** that the poor should have pensions with the judgement that the state should **organise** pension financing. It is, for example, possible for the state to legislate compulsory membership of retirement funds, but leave it to the private market to provide. Furthermore, even if the original justification for public provision is an efficiency rationale, i.e. for protection against inflation, rather than for equity considerations, the scheme can still be financed redistributively. Premiums based on income rather than risk do not cause any major inefficiencies

because there is no adverse selection when retirement insurance is compulsory. Thus, using publicly organised pensions for redistributive purposes does not necessarily cause substantial efficiency losses.

2.2 Pay-As-You-Go versus Funded Schemes

Social and occupational retirement schemes can be financed in different ways. The two most common mechanisms are pay-as-you-go (PAYG) schemes or funded schemes.

The basic principle of a pay-as you-go system is that the contributions paid by the working generation are paid out in the same period to those in retirement. In exchange for their contributions, the current working generation is promised that when they retire, they will receive a pension by the same mechanism.

Funded schemes can be either defined contributions or defined benefit schemes. In a defined contributions scheme the value of the benefit is determined by the accumulated value of the contributions made on behalf of the beneficiary, including the returns on the investment of contributions. After retirement the benefit is converted into an annuity for the duration of the beneficiary's life, the monthly pension being determined by life expectancy and the expected investment returns. The annuity is usually paid out at a flat rate. In a defined benefits scheme, the monthly benefit (pension) is usually equivalent to the number of years' membership of the fund multiplied by a certain percentage of final salary, e.g. 2 per cent for every year worked, with the result that a worker who has worked 40 years for the same firm will qualify for a pension equal to 80 per cent of his final salary. In a defined benefit fund

the employer is responsible for full funding, i.e. he has to pay into the fund the difference between the obligations of the fund and its assets. Thus such an employer "...has much to gain by the departure of members, leaving the employer's contribution... and the bulk of the real pro rata investment income behind" (Field 1991: 971). He is equally discouraged from adjusting pensions of retired workers to keep pace with inflation.

One advantage of a PAYG scheme over a funded occupational scheme is that the value of the pension is dependent solely on earnings and years worked, regardless of how many jobs a person has had, thus removing an important impediment to labour mobility found in occupational schemes (Barr 1998: 207). The same advantage could be achieved in funded pension schemes provided that their benefits are portable. Also, pension rights can usually be built up fairly quickly under PAYG schemes.

3. Protection against Inflation

The erosion of the retirement pension value by inflation is a central consideration and funded schemes and pay-as-you-go schemes differ in the degree of protection they are able to offer. The differential ability of these two schemes to offer protection against inflation depends on whether inflation is rampant during the years in which the pension is being built up, i.e. when contributions are still being paid or when pensions are already being drawn.

Defined contributions schemes cope fairly well in the former case. Contributions are set at a fixed percentage of wages. Consequently, as the price level increases, so do wages and the amount of money contributed by members. In addition, retirement

funds are able to provide real benefits through the investment of pension contributions in inflation-beating portfolios. The latter scenario of inflation while pensions are in payment is more challenging. If the rate of inflation during retirement was anticipated, few problems are faced. Either the expected rate of inflation can be built into the value of the contributions or an annuity can be offered that rises annually with the inflation rate. If, however, the inflation is unanticipated then the fund faces the problem of uncertainty. There are two possible ways to deal with this uncertainty. The fund manager can either hedge against inflation through an internationally diversified portfolio or he can offer limited indexation, but in the latter case, certainty is restored up until the predetermined limit after which the pensioner again bears the costs of inflation. For compensation beyond this level it would be necessary to introduce an element of state financing into social insurance as, in many cases, the only way to index funds is to have the state underwrite them, which means that compensation for inflation is paid out of current tax revenues. If this occurs, the private fund is now no longer a pure insurance fund, but contains an element of government transfer.

In a defined benefit scheme, there is no build-up period. The pension is equivalent to the number of years' membership of the fund multiplied by a percentage of the final salary and, so, if the wage has increased more or less in line with inflation, the final pension should be adequate. Once the pension is in payment, though, the pensioner will find himself the victim of inflation if benefits remain at that level. Consequently, many funds adjust pensions from time to time, but this is discretionary, and it does not usually fully compensate for inflation.

PAYG schemes are generally able to protect pensions against inflation and the real value of the pension can be increased with economic growth. In fact, a study by Samuelson in 1958 (cited in Barr 1998: 207) showed that, in principle, it is possible for every generation to receive more in pensions than it paid in contributions provided that the dependency ratio remains constant. What is crucial is whether sufficient output can be produced by the workers to sustain the consumption of the working and the non-working. If not, there will be too much money chasing too few goods and pensions will not be able to cope with inflation

In South Africa, most changes in the provisions of occupational pension funds take place through negotiations. Consequently, there is no guaranteed protection against inflation and benefits may lag far behind the inflation rate. Consequently, many people may retire under the illusion that they are adequately protected, yet find their income in old age quickly eroded by inflation.

4. Retirement Pension Contributions and Benefits

In South Africa, the state does not itself provide retirement insurance, except to public sector employees. Thus, “social” retirement insurance in fact operates along similar lines to funded private insurance. It is only “social” in that there is compulsory membership in most sectors. The individual may not choose not to be insured and, thus, in these sectors or occupational groups, the impact of occupational retirement insurance is similar to social insurance.

Typically, workers and employers each contribute 7.5 per cent of the monthly wage to a fund from which workers can claim benefits upon retirement. Schemes are

predominantly of the defined contributions type, meaning that the pension is paid out of an account of the individual's accumulated contributions. Contributions to pension schemes are tax-deductible, both for employer and employee, i.e. subsidised through negative income tax. Defined benefit schemes are also prevalent. Occupational retirement insurance is not compulsory, but industrial agreements and competition between employers have resulted in retirement insurance becoming the norm in most of the formal sector and mandatory in many firms and industries. Other benefits attached to membership are withdrawal benefits upon resignation or dismissal, retrenchment benefits, and occasionally, insured benefits to employees who are disabled or survivors' benefits to dependants of members. Funds are administered by boards of trustees according to established rules. Employees have become increasingly better represented on these boards in the past two decades.

A contentious issue has been the withdrawal from funds for reasons other than retirement. South African pensions have not been very portable, i.e. cannot be transferred from fund to fund. Consequently, many workers who have changed jobs or lost their jobs have had part of their benefits paid out to them, which has reduced their retirement benefits and drawn money out of the funds. The Louw Committee's recommendation of compulsory preservation of pension rights upon withdrawal was written into the Preservation of Pension Interests Bill in 1981, but trade unions perceived it as an attempt to deny members access to their own money (Mouton Committee 1992: 153; Rumney 1988: 35) and the Bill was withdrawn.

Withdrawal from a defined benefit scheme makes economic sense for low income workers. Typically, an unskilled worker in the secondary or tertiary sector

accumulates a pension of about R40 per month (2 per cent of final salary) for every year of membership of a defined benefit retirement scheme. An individual who withdraws from the fund after ten years forfeits only R400 occupational pension per month, less than the R540 full social old-age pension for which he now qualifies. In addition, he gets back his own accumulated contribution and some interest, and sometimes even part of the employer's contribution as well. Moreover, the social pension, unlike an occupational pension, can be expected to roughly keep pace with inflation. Thus there is little incentive for an unskilled worker to preserve benefits upon leaving a job.

In older funds, set up with little employee participation, the interests of the employer were dominant, and these were usually to retain staff until retirement. Many funds' withdrawal benefits consisted only of the contributions of the person involved, with little or no accumulated interest, and without the employer's share (Field 1991: 970). This effectively strengthened these funds. Only after trade unions started taking an active interest in retirement benefits did withdrawal benefits become an important part of the benefit structure that employers offered their staff. Whether it is principally the employer or the remaining members who benefit from withdrawal depends on whether it is a defined benefit or a defined contribution fund.

Government's opposition to withdrawal benefits was not based on the level of leakage, which had fluctuated in a narrow band around 10 per cent of the inflow of funds for the past three decades (Mouton Committee 1992: 145), but on the fact that the withdrawal from funds and consumption of the benefits effectively increased the burden on the state to support these people in retirement. Moreover, the inability to

transfer pensions reduces labour market mobility and is a source of labour market rigidity ("golden handcuffs", according to Munro (1991)).

Trade unions, on the other hand, have advanced many reasons for resisting attempts to enforce preservation of pension benefits:

- A worker who becomes unemployed has a more immediate concern with obtaining access to funds than waiting for retirement (Basson 1987: 34), particularly in the absence of a broadly based and adequate unemployment insurance system (Kruger 1992: 213). Furthermore, "...long-term benefits such as pensions were a luxury that poorly paid workers struggling to meet their immediate needs could not afford" (Field 1991: 966).
- As black life expectancy is lower than that of whites, blacks are likely to benefit less than whites due to a shorter life span in retirement (Adler 1989: 20).
- Workers with low incomes fear that occupational pensions may disqualify them from receiving state old age pensions or reduce the value of the state old age pension they would qualify for under the means test. Also, Adler (1989: 20) interprets research done by Møller as implying that "most Black people see the State as the legitimate source of old-age pensions" and therefore do not believe it necessary to provide for their own retirement.
- Workers also argue that employers benefit by any improvement in the financial strength of defined benefit funds, i.e. enjoy a contribution holiday (Trollip 1990: 52). For that reason, workers contend, employers are not keen to improve withdrawal benefits (Adler 1989: 22; Cronjé 1991: 142).

5. Coverage of the Population

About 73 per cent of the formally employed are covered by occupational pension schemes (Mouton Committee 1992: 490; Smith Committee 1995: D.2.11), but as contributions do not flow through state coffers, international fiscal comparisons usually understate social security provision in South Africa. In 1993, 44.5 per cent of older persons benefited from retirement funds and 78.7 per cent from social pensions (Smith Committee 1995: D2.8). Although coverage of the formally employed seems high, large unemployment and informal sector participation mean that only some 40 per cent of the labour force are covered. In 1990, more than 2.2 million employed workers were uncovered by occupational insurance (Mouton Committee 1992: 115-116). In addition, the number of people uncovered is increasing due to rising unemployment (Kruger 1992: 215). Coverage is low in the agricultural, catering and accommodation, trade and domestic service sectors. These sectors' combined employment was about 2.6 million in 1990 (Mouton Committee 1992: 115-116). In particular, the majority of black workers, many of whom are employed in these sectors, are not catered for.

6. Provident versus Pension Funds

Many low income workers prefer provident funds to pension funds. They often prefer a lump sum benefit at retirement so that they are able to buy assets that are not penalised by the means test for social assistance pensions, such as land, cattle or a house (Basson 1987: 34). After the 1981 industrial unrest there was a proliferation of provident funds because they were perceived to better serve workers' interests because workers had participated in the formulation of their rules. Thus the perception

grew that provident funds were better for workers than pensions funds. In fact, though, there is very little difference:

- Firstly, member contributions to a pension fund are untaxed but pensions received are taxed. For provident funds, however, earners pay the full income tax on their contributions but receive a substantial tax benefit when retiring (Cf. Sephton *et al.* 1990: 26 et seq.). Both funds do not tax the beneficiary for between 10 per cent and 20 per cent of earnings contributed by the employer (Sephton *et al.* 1990: 21-29). Up to that level, pension benefits are more attractive than increases in salaries from an employee's standpoint.
- Secondly, pension fund members can receive not more than one-third of their benefits in the form of a lump sum pay-out and the rest must be in the form of a monthly pension. Provident fund members, however, can take all their benefits in the form of a lump sum. "The fact that pensions are penalised more than lump sums at retirement in the 'means test' for old age assistance, has also led some lower paid employees to prefer provident funds to pension funds" (Mouton Committee 1992: 154). This may result in "dumping" on the social old age assistance scheme if lump-sum benefits are quickly used up.

Suggestions for alternative retirement plans often revolve around the tax differences between pension and provident funds.

7. Pensions in the Public Sector

Public sector pensions are provided by the Government Employees Pension Fund that operates by broadly the same rules as other occupational pension funds. During the 1970's and 1980's, however, government increasingly under-funded the public pension fund, thus improving its fiscal position in terms of the public deficit, but at

the same time creating growing uncertainty about the funding of public sector pensions. It has now again undertaken to redress this backlog, a process that is now well advanced and that has made it even more difficult for government to reach the deficit targets it has set itself as part of its macro-economic strategy. However, there have been demands from trade unions and religious groups for public pension funds to be funded on a pay-as-you-go basis. This would temporarily free up government resources, but in the long term is no different from an increase in the public debt. The effect would be to increase the burden on future generations to fulfil those commitments.

8. Private Insurance, Social Insurance and Social Assistance

Amongst higher income groups there is widespread reliance on private pensions to supplement occupational pensions, while self-employed professionals often opt for retirement annuities. However, voluntary membership of private or occupational insurance funds is not attractive to lower income workers. They would rather fall back on social old-age pensions in retirement as the means test effectively applies a 50 per cent tax on private income. Thus, an important dilemma lies in the articulation between social insurance and social assistance for retirement.

As will be seen in Chapter 8 on social old age pensions, the effective marginal tax rate makes it unattractive to people in a certain income band to earn more private income, as they would lose part of it through a reduced grant. For example, a retiree receiving an occupational pension of R500 in 2000 would have his social pension reduced by R169, thus receiving a total income of R871, only R331 more than he would have received as a full social pension had he paid no contributions whatsoever.

Consequently, there is a disincentive to earn income or to provide for retirement. The means test also creates incentives to withdraw benefits before retirement, to neglect to take out private retirement insurance when one has the resources to do so, to choose lump sum retirement benefits rather than pensions, or to hold assets in a form favoured by the provisions of the means test. The impact is particularly acute at low income levels where it acts as a "serious disincentive to saving or continuing to work" (Mouton Committee 1992: 85).

Social old-age pensions can be designed so as not to discourage private pension provision. A possibility is to implement the Mouton Committee's recommendations (1992: 231), viz. preparing the way for compulsory (provision and) preservation of retirement benefits. In 1997, the National Consultative Retirement Forum failed to reach finality on the issue of the portability of funds and a universal social pension. Industry-wide funds could be encouraged, where job changes within an industry do not constitute withdrawal from a fund.

Another possibility would be to enforce improvements in withdrawal benefits that would provide the full interest on their contribution to workers in cash, while preserving the full employers' contribution for them. This would increase costs of retirement insurance and thus tax the use of labour, but if the incremental cost is small compared to the wage bill, the disincentive to employment would be negligible.

9. Conclusion

Occupational retirement insurance is large and growing. It would appear that the private market is succeeding in supplying insurance at an appropriate price to many

South Africans. However, as membership is dependent on a formal attachment to the labour market, it cannot cater to the unemployed. There is no social retirement insurance for those who have spent large portions of their adult years outside of employment. If occupational insurance is to be expanded, stable and well-remunerated employment will first have to be created. For the moment, those not covered by occupational pension arrangements – the unemployed and the informally employed - will remain reliant on social old-age pensions

CHAPTER 4

SOCIAL INSURANCE AGAINST UNEMPLOYMENT

1. Introduction

Unemployment insurance is provided for by employer and employee contributions to the Unemployment Insurance Fund (UIF). The objective of the Fund is to “alleviate poverty by providing effective short-term unemployment insurance to all workers and helping them to find reemployment” (Department of Labour 1997a: 5), i.e. to combat the effects of frictional unemployment (Department of Labour 1997b: paragraph 372). The UIF is thus a contributor-funded social insurance scheme, not a state-funded safety net for the unemployed, and does not focus on meeting the needs of the long-term unemployed.

2. A Theoretical Perspective on Unemployment Insurance

The potential for private provision of unemployment insurance as an alternative to the prevailing system is limited. Despite a clear demand for unemployment insurance, the private market fails to supply the quantity of insurance desired by consumers. Unemployment insurance is an area where one of the clearest cases for government intervention due to market failure can be made.

2.1 The Difficulties of Private Unemployment Insurance: the Supply Side

Analysed in terms of the criteria for the private provision of insurance outlined in Chapter 2, it is evident why the supply side breaks down. A now-familiar range of problems and challenges present themselves.

Although for the work-force as a whole the probability of becoming unemployed is less than one, there are certain groups that run such a high risk of becoming unemployed, such as young school-leavers or very unskilled people, that the private market would consider them too risky to insure. Or, if the market is willing to provide, the probability of these groups' unemployment is so high that they would not be able to afford the corresponding high premiums. As was noted in Chapter 2, this market failure is not a sufficient justification for social insurance. In fact, it is only an argument for compulsory membership of insurance funds. When all the employed are obliged to contribute, it is possible to estimate the average risk of unemployment and, so, pool the risk of all the employed. The state would intervene by legislating compulsory membership, but the actual provider of insurance could be the private market or the state.

Compulsory membership of funds would not solve the problem of cream-skimming or cherry-picking, though. The existence of a multiplicity of private funds may result in funds competing for low-risk members by offering lower premiums and benefits. A possible solution to this is to legislate guaranteed acceptance of workers into the fund of their choice. If the insurance policies of different funds are not too dissimilar, this should achieve a relatively even spread of high-risk contributors across the funds. The idea is that the higher contributions of the low-risk high-income earners would cover

the payment of benefits to high-risk low-income earners, in the same way as would occur in a single state-administered fund. The provision of unemployment insurance would be in private hands, but the state would create the regulatory framework within which the funds would operate.

In a non-compulsory private market situation, adverse selection is likely, especially seeing that employees usually have a fair idea of how vulnerable their jobs are to employment cut-backs. In private markets this can be overcome to an extent by examining the applicant's employment history and the vulnerability of his job sector, and setting the premium accordingly. In administrative terms this solution is costly, though. More importantly, it is regressive and can lead to significant gaps in coverage as those in the most vulnerable job categories are generally also the most poorly paid who cannot afford the high premiums associated with their high risk. These people then become reliant on social assistance benefits. Thus, it is in the state's interest to have a well-functioning social insurance scheme for unemployment. This is one reason why the state often intervenes to set up a single fund, such as the Unemployment Insurance Fund, to which it is compulsory to contribute. It is very difficult for an insurance scheme to protect workers in low-paying, high-turnover occupations without government subsidisation (Naidoo & Wagenstroom 1995: 6).

The problem of moral hazard is rampant: it is very easy for an individual to influence the probability and duration of employment. Moreover, when unemployment benefits are generous the psychic cost associated with unemployment is diminished. In addition, significant severance packages are often provided, especially for higher income workers. In some systems, very generous benefits provide such an incentive to

opt for leisure rather than work, that unemployment may have psychic gains associated with it. Also, if there is a high degree of structural unemployment in the economy and the discouraged worker effect is prevalent, stigma is lower and the benefits of job search diminish, with the result that the period of unemployment endures longer than it might otherwise have. It is only when there is severe social stigma attached to unemployment that the endogenous probability problem of unemployment diminishes. The fact that the probability of unemployment is endogenous makes it impossible for insurance companies to set a premium and, so, almost nowhere in the world is private unemployment insurance provided.

Another problem, generally in countries with high structural unemployment or large cyclical swings, is that unemployment becomes a common risk. In the case of a cyclical recession, vast legions of workers are laid off at once, threatening the financial position of insurance funds. However, provided that enough employees from a broad range of sectors are insured, it is possible for private insurance to provide. This is because business cycles, and therefore risk, can be more or less predicted. The condition is that sufficient numbers of workers are insured for cross-subsidisation to occur. For this, compulsory unemployment insurance is generally necessary.

Of a more serious nature are unpredictable macroeconomic shocks; unforeseen events that send the economy into crisis and cause wide-scale unemployment. This is an example of uncertainty rather than risk and a common shock where individual probabilities of unemployment are not independent. Therefore, private firms would not consider it profitable to provide insurance.

It is important to note, once again, that the resulting public institutions that provide for unemployment insurance do not look actuarial. They cannot be called insurance providers in the actuarial sense of the definition, but are only insurance providers in the sense of providing protection against the risk of a loss of income.

2.2 Incentive and Economic Effects

The chief aim of UIF benefits is to provide the beneficiary and his family with an income to sustain them in times of unemployment. Benefits may also increase the likelihood of reemployment because an unemployed worker with some income is in a better position to cover the costs involved in job search (Naidoo & Wagenstroom 1995: 2). Furthermore, the worker is not forced to bear the costs of contributions alone - the government and employers also contribute. Finally, in South Africa, unemployment insurance redistributes income by transferring income from securely employed (mainly white) workers to vulnerable (mainly black) workers in high-risk employment categories.

On the other hand, state provision of unemployment insurance may create a number of economically undesirable disincentives. Attention was given to this issue in Chapter 1 of this thesis, but some of these points are worth repeating with specific reference to South Africa. The provision of unemployment insurance may discourage job search because when an unemployed person is rehired he sacrifices unemployment benefits and leisure, and his new wage is taxed. In South Africa, however, the low levels of benefits and the low tax rate applicable to most beneficiaries of unemployment insurance make it unlikely that the receipt of benefits discourages job search. About 70 per cent of beneficiaries earn less than R1 500 per

month and thus are subject to very little income tax (Meth 1997: par.5.5). In addition, the Unemployment Act stipulates that a beneficiary must actively seek employment in order to qualify for benefits and is obliged to accept any position the claims officer deems suitable for him. Another common argument, namely that extended unemployment leads to a depreciation of skills, is also scarcely relevant in South Africa, where most of the unemployed are already low-skilled. In addition, the six-month ceiling on benefit payments should preclude any serious deterioration of skills.

3. Unemployment Benefits

To qualify for benefits, the employee must have been contributing to the UIF for at least thirteen of the previous fifty-two weeks and have accumulated sufficient “credits”. Credits are accumulated at a rate of one week’s benefits for every six weeks contributions, which means that an employee must have contributed for three years to accumulate the maximum twenty-six weeks benefit. Furthermore, the recipient must be capable of and available to work, and actively seeking employment.

If these conditions are met, the beneficiary is entitled to a monthly benefit equal to 45 per cent of his income averaged over the last thirteen weeks prior to unemployment. Benefits may be paid for a maximum of 26 weeks which, compared to systems in other countries, is very limited. This is especially problematic for older workers who are less likely to be re-employed. Compared to the contributions paid, benefits received are disproportionately *high*. For example, someone earning a fixed salary for three years would have contributed 1.56 times (1 per cent per week for 156 weeks) his weekly earnings at the end of that period. If he then becomes unemployed, he would be eligible for benefits of 45 per cent of his weekly wage for 26 weeks, i.e. in total

almost 12 weeks' wage or 7½ times as much as he initially contributed. However, the low wages paid in South Africa result in comparatively small monetary benefits.

Illness benefits are also provided for. Under the Basic Conditions of Employment Act, an employee who works a normal five-day working week is entitled to thirty working days sick leave during a thirty-six consecutive working month period, during which he can claim benefits under the Unemployment Insurance Act.

Maternity benefits under the UIF may be accessed by female employees for a maximum period of twenty-six weeks. However, when they do so, they forfeit their accumulated unemployment insurance credits. Women are entitled to these benefits only if they receive less than one third of their normal salary from their employers during maternity. This condition may discourage employers from offering more generous benefits themselves. Also, because women are often employed in low-paying sectors of the economy, a maternity benefit of 45 per cent of normal wages may be very low.

Dependants of deceased contributors may also receive accumulated benefits in the event of the death of a contributor. The benefits are paid to the widow or widower, or if there is no spouse, to the deceased's children provided that they are under seventeen years of age and were mainly dependent on the deceased.

The wide range of benefits offered by the UIF is a source of many of its administrative and financial problems, and it has now become the stated objective of the UIF to limit involvement in activities outside specific insurance matters (Department of Labour 1997a: 5).

4. Contributions to the Fund

Employees and employers each contribute an amount equal to 1 per cent of the employee's monthly earnings to the UIF. This is supplemented by the state's contribution of a further 25 per cent of the collective contributions of the employer and employee up to a maximum of R7 million⁹ per year. According to Meth (1997: 6.1), South Africa is one of the few middle income countries that obliges employees to contribute and the employer contribution is relatively small: international comparisons show that employer contributions can range from 3 per cent to 10 per cent of the payroll. The UIF considers it the employer's responsibility to deduct monthly contributions for submission to the UIF. For each employee, the employer keeps a contributor's record card ("blue card") which must be completed with the details of the employee's period of employment and remuneration and presented to the unemployment office before he can claim benefits.

A core problem of this system is that it is employer-driven. It is the employer's responsibility to register with the UIF and to submit the contributions. This leaves room for abuse by employers who may under-contribute to the fund and then fill in an inflated final wage value on the blue card; evade contributions altogether; or neglect to register employees timeously, thus delaying the receipt of benefits. These problems are aggravated by the fact that it is difficult to trace defaulting employers and, when caught, they are not heavily fined. Employees, too, abuse the system by declaring themselves unemployed when they are not. In 1996 alone, 8 809 cases of unlawful receipt of benefits were identified, resulting in the recovery of R34.3 million (Department of Labour 1997a: 15). Employers are also sometimes ignorant of their

obligations to register employees and remit contributions, and are unsure of the procedures to follow. Employees are poorly informed of their rights to apply for benefits and are sometimes even unaware that contributions are being paid into an insurance fund on their behalf. Application forms for benefits are also considered fairly complex and are not always available in a language with which the applicant is comfortable.

It has been recommended that a system of “individual-based record keeping” be implemented (Department of Labour 1997b: paragraph 381). Each employee would be responsible for his own card, would be able to monitor the information it contains and be free to work for multiple employers without forfeiting benefits.

5. The Coverage of the Employed

At its inception in 1946, the UIF was geared towards alleviating the Poor White problem and, consequently, many categories of workers such as agricultural workers and black miners were excluded. In 1980, only 3.6 million people out of an economically active population of 9.5 million were registered as contributors¹⁰ (Department of Manpower Utilisation 1981). Then, between 1976 and 1981, the Unemployment Insurance Act was amended to assist with the creation of unemployment funds in the former independent homelands of Transkei, Bophuthatswana, Venda and Ciskei. Mismanagement of funds led to the re-incorporation of homeland employees into South Africa’s unemployment fund in

⁹ In practice, the state contributes this maximum every year.

1983 and by 1996, under the Integration of Labour Laws Act of 1994, the South African Unemployment Insurance Act was fully operational in all of South Africa. Workers in rural areas (excluding agricultural workers) were incorporated into the UIF in 1979 and black miners in 1981. Since then the coverage of the UIF has been further extended, raising the number of contributors to 4.9 million in 1992 (Meth 1997) and at the beginning of 1993, the Act was extended to agricultural workers.

Still excluded from coverage by the Act are many government employees, domestic workers, casual and seasonal workers, the self-employed and the informally employed:

- Permanent employees in central government are not covered by the Act because they presumably enjoy job security and, therefore, have no need to contribute to an unemployment scheme (Public Servant 1992: 8). Also, they may draw on their state pensions if they lose their jobs. However, current rationalisation and privatisation measures by government are perceived to pose a threat to this security and drawing on pensions during unemployment reduces income during retirement.
- Domestic workers remain outside the coverage of the UIA and their inclusion is proving problematic. Administration of contributions is difficult because domestic workers often work for multiple employers; it is also difficult to ascertain when a piecework employee should be classified as unemployed; and it is relatively easy for domestic workers to abuse the system by drawing unemployment benefits and continuing to work. One possible way to expand coverage to this sector is through

¹⁰ These figures exclude the populations of the former independent homelands of Transkei, Bophuthatswana, Venda and Ciskei who were not permitted membership.

trade unions. Domestic workers could register themselves with a trade union to which both employer and employee will pay funds, based on the number of hours worked for each particular employer. This necessarily implies the regulation of what is currently largely informal employment, eroding some of the mutual benefits of this kind of work.

- Casual and seasonal workers are excluded because they often do not fulfil the requirement that the contributor must work for at least eight hours or one full working day per calendar week. In addition, they are usually not employed long enough to accumulate thirteen weeks of uninterrupted contributions and sufficient credits.
- Informally employed and piece workers lack the structures to participate in unemployment insurance schemes. Independent contractors and the self-employed are also excluded from coverage by the Act.
- A final important category is people who are unable to contribute to the Fund because they have never been employed. In South Africa this is a significant proportion of the population and includes school-leavers, housewives entering the job market for the first time and civil servants wanting private employment - the very workers at the greatest risk of unemployment.

A racial bias in the coverage of employees by unemployment insurance is evident because most of the excluded workers are black. However, the nature of the work that these workers are involved in means that their payments are difficult to administer and most do not earn sufficient income for a long enough period to contribute according to the regulations laid down by the UIF. Nevertheless, it is now the aim of the UIF to extend unemployment coverage to all who are currently excluded (Department of Labour 1997a: 5) - a policy supported by many organised interest

groups, including the labour movement, community groups, the International Labour Organisation, the Labour Market Commission and Business South Africa (Meth 1997: 4.6.2.).

In addition to sectors not covered, there is an income ceiling on the unemployment scheme, above which employees are excluded from membership of the Fund. The ceiling is adjusted annually so that members are not disqualified purely because of inflation and as from 2001 the ceiling will be set at R97 188 per annum (Department of Labour 2000a). The assumption is that higher income earners are generally skilled enough to find new jobs relatively easily and are also capable of making private provision for unemployment. There is an argument for the extension of benefits to these earners, though: The size of their contributions is relatively large, but the probability of their unemployment is relatively low, which should help improve the solvency of the Fund and effect some redistribution (Department of Labour 1997b: paragraph 394). In other words, the inclusion of upper income earners would facilitate risk-pooling and their contributions could cross-subsidise higher risk members. Their membership may even facilitate the inclusion of other groups that are currently excluded because of their high-risk character. Indeed, the recent Unemployment Insurance Bill (Department of Labour 2000b) proposes that all income earners be included into the scheme, but that those who earn above a threshold of R132 000 pay contributions and receive benefits as if their income was R132 000.

Setting minimum and maximum levels of benefit does help to maintain the solvency of the Fund. It enables the UIF to provide lower-paid contributors with a larger benefit in times of unemployment, and to incorporate higher income earners into the

scheme without running the risk of exorbitant benefit payments. This measure appears to be quite popular internationally (Meth 1997: Chapter 6). However, it does undermine the effectiveness of unemployment insurance as an instrument of income maintenance, especially for upper income earners. The setting of minimum and maximum benefits results in differentiated income replacement rates with those at the lower end of the spectrum receiving more than 45 per cent of their income as benefits and those at the upper end receiving less than 45 per cent.

An alternative is the sliding scale benefit structure that has been proposed by the Unemployment Insurance Bill (2000b: Appendix Schedule 1). The percentage of income that is compensated for will fall as income increases so that replacement rates range from 58.6 per cent of earnings, if income is R150 per month, to 38 per cent if monthly income is R7 774. This would further weaken the objective of income maintenance and increasingly emphasise the objective of poverty alleviation.

Contributors rendered unemployed due to participation in a strike or as a result of a lock-out are not entitled to unemployment benefits, unless they can prove that they were not directly involved in the dispute or if their participation resulted in a lengthy period of unemployment. The receipt of a retrenchment package or severance pay does not disqualify a person from the receipt of unemployment benefits.

6. The Administration and Financial Position of the Fund

The UIF was originally intended to serve the interests of relatively well-paid, fairly secure white workers, but now has extended its coverage to other categories of workers who have less job security and smaller incomes. However, the institutional

structures have not changed accordingly and this is a source of many of the UIF's administrative and financial problems.

The Fund is administered by the Unemployment Insurance Commissioner with the Director-General of Labour as trustee and an Unemployment Insurance Board to hear appeals. At the provincial level, there are benefit committees in ten main centres that utilise the offices of the Department of Labour. Under these main centres reside more than 500 pay-points which range in size from full-time Labour Centres to satellite offices that are visited on a periodic basis. Despite staff shortages the Fund has been very efficient in the payment of benefits. In 1996, there was not one case where payments were not made on the scheduled day (Department of Labour 1997a). However, there remains a four to six week waiting period between the date of application and the receipt of the first benefit.

Financially, the UIF is facing difficult times. Expenditure on benefits has exceeded income for more than five years, in 1996 by R158.6 million (Department of Labour 1997a: paragraph 47). Although the total income of the Fund has increased, this has been mainly as a result of general wage increases, whilst the Fund has battled with employers who have withheld payments (Naidoo & Wagenstroom 1995: 9). Also, the number of beneficiaries and, consequently, administrative costs have increased. In the first eight months of 1998, about R270 million was paid out per month to beneficiaries, 85 per cent of which was spent on unemployment benefits and the remainder on maternity, illness and dependants' benefits (Department of Finance 1999a: 231). To cover any deficit the Fund may draw on interest received on investments and cash balances, as well as sundry income from items such as penalties

and rentals, in addition to the contributions from employers, employees and the state. In addition, head office accounts do not always reconcile with the balances of the various regional office accounts with recorded discrepancies of up to R12 million (Republic of South Africa, Auditor-General 1995: 2). In 1994, the government agreed to lend the Fund R60 million per year for the next five years to help cover the deficit (Naidoo & Wagenstroom 1995: 2).

7. Conclusion

The UIF does provide a social security net for all of South Africa's employed contributors and, it appears, does so fairly well given the low level of contributions. This net only extends to those affected by cyclical unemployment, though, as it is not the intention of the Fund to support the long-term unemployed. Moreover, a complementary unemployment assistance scheme to protect the vast numbers of unemployed people who do not contribute to the UIF at present does not appear to be fiscally viable.

CHAPTER 5

SOCIAL INSURANCE AGAINST OCCUPATIONAL DISABILITY AND DISEASE

1. Introduction

Social insurance for disability in South Africa is only provided for work-related injuries and diseases, and not for disability in general, under the Compensation for Occupational Injuries and Diseases Amendment Act (COIDA) of 1997. The Act entitles employees to compensation from the Compensation Fund for workplace-related injuries, disease or death according to the principle of “no fault compensation”, i.e. compensation is awarded without it being necessary to prove that the accident was not the employee’s fault. Compensation is provided for temporary disablement, permanent disablement or death, and covers the payment of medical costs, funeral costs and compensates the disabled person or his survivors for a loss of earnings. The Compensation Fund is financed by payroll contributions by employers and employees, insuring employees against a loss of income and employers against exceptionally high compensation claims.

2. A Theoretical Perspective on Social Insurance for Occupational Disability and Disease

The theoretical justification for the social provision of workmen’s compensation arises more from a need to protect the interests of employees than from any failures of the private market. The Compensation Fund’s main aim is to ensure that employees receive their just compensation in the event of an injury or disease.

Under common law, an employee would have the right to claim damages from his employer for any injuries caused during employment and which arose from the negligence of the employer (Antoniou 1992: 39). However, unless he could prove that employer negligence was the cause of his injury, he would not receive compensation. Furthermore, an employee would have to bear the costs of suing his employer and have a good understanding of the medical and legal issues involved. Even then, the employer may not have the assets to pay sufficient damages. The high legal costs associated with lawsuits may also render damage claims inefficient from a social perspective. For example, common law damage payments for motor vehicle accidents in 1993 amounted to R500 million in payments to accident victims and R150 million to lawyers (Benjamin 1995: 84). COIDA avoids these costs by establishing a principle of “no fault compensation” (Antoniou 1992: 39) whereby an employee can claim compensation for workplace-related accidents regardless of the employee’s own negligence. All that an employee need prove is that an incident occurred at work and resulted in injuries or a disease that detrimentally affected his earning capacity. Thus, the employee receives a guarantee of compensation in exchange for sacrificing his common law right to sue for damages and the employer is spared costly damage claims by, instead, making “regular and predictable payments” to the Compensation Fund (Benjamin 1992: 3). Many observers believe that this also minimises the harm done to the employer-employee relationship (Mischke and Garbers 1994: 73).

3. Contributions to the Fund

Compensation is paid from the Compensation Fund, administered by the Compensation Commissioner. Employers are responsible for the payment of assessments to the Fund. The exact size of the assessment is based on a percentage of

the annual earnings of all employees and the Commissioner's evaluation of the safety of the specific industry. It can be increased if a firm has a very poor accident record, but this is seldom done in practice (Benjamin 1992: 86). A minimum or maximum assessment may be set if the Commissioner deems it desirable. This would enable relatively poorly paid workers to receive a level of compensation sufficient to meet their basic needs, but still retain the solvency of the Compensation Fund by reducing payments to upper income earners. However, it would severely weaken the objective of income maintenance as it would lower the replacement rate for higher earners. The payment of assessments is compulsory for all firms, but with the Commissioner's approval it is possible for firms to use their own mutual insurance schemes to cover their potential liability under the Act. Such employers are termed "individually liable" and are exempt from the payment of assessments. Instead they submit premiums to a mutual association and, in the event of an employee injury, the employee is paid an amount equal to the compensation he is entitled to under COIDA. There are only two mutual associations licensed for this purpose, one for the mines and one for the building industry, namely Rand Mutual and Federated Employers' Mutual Fund. The only other employer exempt from paying assessments is the state.

4. The Benefit Structure

Four categories of compensation are recognised by the Act: temporary partial disablement; temporary total disablement; permanent disablement; and death. These categories refer to a partial or total inability of the employee to perform the work for which he was employed (or similar work) at the same level of earnings, temporarily or permanently. The amount of compensation is determined by the employee's earnings at the time of disablement and the severity of the injury or disease. Periodical

compensation payments to a temporarily disabled person continue until the disability terminates, he is able to resume work at a similar or higher remuneration, or he is awarded compensation for permanent disablement. In the case of the death of the employee, the widow(er) and dependants will be paid compensation if they were financially dependent on the employee. The Commissioner has a fairly wide discretion in calculating these benefits.

4.1 The Benefit Structure for Disability and Death

An employee who is temporarily and totally disabled receives a temporary disability benefit of 75 per cent of his monthly earnings, up to a maximum of R7 712.25 per month. The temporary disablement benefit is available for a period of up to 12 (or in special cases 24) months. The Commissioner will also pay the medical aid costs incurred by the employee for up to two years, and will extend benefits for an even longer period if further medical treatment is required to reduce disablement.

If an employee suffers a permanent disablement his compensation is calculated in terms of the severity of the injury. If the disablement is assessed at less than 30 per cent he will receive a lump sum payment, otherwise a pension. Those who are totally disabled (100 per cent) earn an occupational pension equal to 75 per cent of the employee's earnings at the time of the accident, up to a maximum of R7 712.25 per month until retirement age. Minimum earnings of R1 081.00 per month are assumed, regardless of actual earnings, so that the minimum pension awarded for the total disability benefit is a R810.75 per month. The pension is proportionately reduced for less severe disabilities. As far as lump sum payments are concerned, an employee will receive compensation equivalent to one month's benefits for every 2 per cent of

disability. For example, 30 per cent disability will entitle the employee to a lump sum payment equal to 15 times his monthly earnings at the time of the accident. Here, too, a maximum lump sum benefit is set, at R86 415. Occupational disability benefits are not taxed.

In the event of death, the widow(er) receives a lump sum payment equivalent to twice the benefit for 100 per cent disability, plus a monthly pension of 40 per cent of the pension the deceased would have received for 100 per cent permanent disability (i.e. 30 per cent of the deceased's earnings) (Mischke & Garbers 1994: 106). Children receive pensions of 20 per cent each. Other dependants may receive pensions of 40 per cent. However, survivors' benefits together may not exceed R7 712.25 per month, i.e. they may not exceed the monthly pension for total disablement. In addition, compensation for funeral costs is provided up to a maximum of R6 182.00. Workers and unions are permitted to negotiate with employers to top up these benefits with the firm's private funds.

The employee is entitled to some increased compensation if the accident or disease arose due to negligence by the employer or a third party, such as a fellow employee (Antoniou 1992: 39). Increased compensation is paid if the accident was caused by a defect in the condition of the premises, works, plant, material or machinery which the employer knowingly or negligently failed to rectify.

Compensation may also be denied to employees under certain circumstances. If the accident was caused by the "serious and wilful misconduct" of the employee, his claim may be rejected. By this it is meant that the employee was injured while, for

example, intoxicated, under the influence of narcotic drugs or wilfully acting in contravention of any laws designed to protect employee health and safety. Compensation may also be denied if the employee falsely claims that he was not previously suffering from a disease or injury, and it is discovered that the disablement did in fact result from the aggravation of a previous disease or injury. Another reason for the rejection of a compensation claim is if the Commissioner is convinced that the death or disablement was caused or aggravated by the employee's unreasonable refusal to submit to medical treatment for an accident or a previous injury or disease (Mischke & Garbers 1994: 87). Finally, compensation is awarded only if the period of disablement exceeds three days.

4.2 The Benefit Structure for Disease

The calculation of compensation for occupational disease is similar to that for occupational injury and is also dependent on the severity of the disability arising from of the disease. The range of occupational diseases covered by COIDA has broadened significantly. It now complies with the standards recommended by the International Labour Organisation. Employees can also be compensated for any unlisted disease if it can be proven that the disease arose in the course of workplace duties. Occupational asthma and repetitive strain disease are two important inclusions in the new list (Canau and Gon 1994: 4). It is important that the list of occupational diseases is regularly revised because as technology develops and working conditions change, the number of workplace-related diseases may increase and new medical conditions may emerge.

Multi-causal diseases, to which working conditions may contribute, but are not solely responsible, pose a problem. It is not always possible to determine to what extent the work-place contributed to the development of the disease.

In addition to the Compensation for Occupational Injury and Diseases Act, the 1993 amendment of the Occupational Diseases in Mines and Works Act allows mining workers to claim benefits for a range of common mining diseases. The benefits under this Act are not as generous as under COIDA: no pensions are paid and compensation payments are very low (Benjamin 1995: 84).

4.3 Criticisms of the Benefit Structure

The calculation of benefits for temporary disablement has been criticised because it applies the same percentage basis to all earning levels. In other words, benefits received are in direct proportion to salary earned. For example, an employee earning R1 000 per month will be awarded R750 in benefits and an employee earning R4 000 per month will receive a pension of R3 000. This may result in a benefit that is too low to meet daily subsistence needs: lower paid employees usually spend all their income on basic necessities and have few savings to rely upon if rendered unemployed due to illness or injury. It has been suggested that a progressive payment system, such as that proposed for unemployment insurance, be introduced where workers at the lower end of the salary scale receive a greater percentage of their earnings as compensation (Benjamin 1995: 82). There is already some progressiveness in the existing benefit structure, though, as a result of the maximum and minimum disability benefits that may be awarded. A minimum disability benefit of R810.75 per month means that employees at the lower end of the income spectrum

face replacement rates of close to (and even higher than) 100 per cent. Upper income earners, on the other hand, may face replacement rates of as low as 25 per cent if they earn in excess of R25 000. Thus, although the aim of COIDA legislation is income maintenance, it does effect some degree of redistribution.

Criticism has also been levelled against the compensation provided for permanent disablement. South Africa's large pool of unemployed labour means that a relatively small injury can prevent a person from finding re-employment, yet the pension he receives for such an injury may not be enough for him to survive on. Even a worker whose injuries are not severe enough to qualify him for a pension may be rendered unemployable. The disabled also run a higher risk of dismissal or first-out retrenchment (Ehrlich 1992: 5).

Related to this is another glaring shortcoming of COIDA, namely, the lack of provision for any form of rehabilitation scheme whereby disabled workers can be trained to re-enter the job market in a different capacity or to become self-employed. Furthermore, employers are not obliged to re-employ injured workers or to adapt working conditions to accommodate their disability.

A further inadequacy of the system is that pensions are not increased annually in line with inflation. During the 1980's pensions increased at a mere third of the inflation rate and in 1995 pensions increased by 6 per cent while the inflation rate was 10 per cent (Benjamin 1995: 83).

Finally, in South Africa, employees are only compensated for a loss of earnings with no compensation being awarded for pain and suffering (Canau and Gon 1994: 1) or the modification of lifestyle that a recently disabled person has to make. Under common law an employee would have had the right to claim damages for pain, suffering and the loss of amenities. Now, other household members may be forced into the job market to support themselves and the disabled person.

These features (or lack thereof) contrast strongly with compensation schemes in developed countries where compensation is regularly adjusted for inflation, rehabilitation schemes are in place, and employers are obliged to re-hire disabled employees wherever feasible.

5. Coverage of the population

COIDA has expanded the proportion of the working population insured against occupational disability significantly. Casual workers and workers provided by labour brokers are now included. The income ceiling of R80 000 per annum (Mittner 1997: 73) which once excluded higher salary earners from participation in the scheme has been removed. As most high-earning employees are not employed in high-risk occupations, their contributions should aid the solvency of the Fund – especially as the benefits they are entitled to are capped. Employees are eligible for compensation regardless of whether their contracts of employment are express or implied, oral or in writing and whether remuneration is calculated by time or by work done, or is in cash or in kind (Canau and Gon 1994: 1). They are also eligible for benefits regardless of how long they have been employed by a particular employer or how many hours of labour they perform per week. Categories of employees still excluded from coverage

by the Act are members of the Permanent Force of the South African Defence Force and others performing military service, members of the South African Police Services, people involved in “contract work” and, very importantly, domestic workers. The difficulty associated with extending coverage to domestic workers is that many perform piecework and, thus, there is no single employer to pay assessments on their behalf. It is also difficult to determine under whose employ a domestic worker met with injury or disease. It is argued that if coverage were extended to all currently excluded workers significant economies of scale could be realised. Also, the complex bureaucratic activities required to determine eligibility could be avoided (Benjamin 1992: 4).

6. Financial and Administrative Considerations

The Compensation Board is the key organ in the administration of disability insurance. It is a tripartite advisory board composed of members of the state, labour and organised capital (Canau and Gon 1994: 2) and advises on policy matters, the nature of benefits to be paid and the appointment of assessors. The Board consists of the Compensation Commissioner, three state officials, an equal representation of employers and employees, two members representing the mutual associations and two persons nominated by the South African Medical Association.

The system is very much employer-centred. The employer is not only responsible for the management of contribution payments to the Fund, but also for the payment of compensation to the employee for the first three months of temporary disability (for which he is later reimbursed by the Compensation Fund). The employer must do this even if the employee is dismissed or if his contract expires. This is in order to speed

up the payment of benefits (Benjamin 1995: 81). Some unions have even negotiated that employers will pay employees their full wages due to absence during an injury. The employer is also responsible for the costs incurred to transport the injured employee to home or to the hospital and may not demand or accept a contribution towards the costs of medical aid supplied.

Some empowerment of the employees could help to alleviate another problem: the under-reporting of occupational diseases. Many workers are ignorant of their rights under the new scheme, as the government has failed to publicise the benefits available to employees under the Act effectively and many employees lack sufficient access to medical facilities, specifically specialist occupational health doctors. Furthermore, many workers are wary of claiming compensation because they fear this will lead to their dismissal. Trade unions could be used very effectively here to monitor employer compliance with the Act and to disseminate information to employees about their rights. Special effort needs to be taken to ensure that the employers and employees of small businesses are properly informed.

A final administrative problem to be considered is the existence of two parallel sets of legislation, namely COIDA and the Occupational Diseases in Mines and Works Act. A single uniform system would simplify administration, avoid the duplication of expensive infrastructure, standardise benefits for similar diseases and enhance efficiency.

The Compensation Fund for occupational injury and disease is in a satisfactory financial position, managing to adequately meet its obligations. The most recently

available figures place the income of the Compensation Fund at R890 million. Expenditure on disability pensions and lump-sum payments amounted to R597.9 million, R258.6 million of which was spent on permanent disability and R268.3 million on medical costs (Mittner 1997: 73). The former figure is increasing as the reporting of accidents improves and the latter is expected to increase in coming years as medical costs rise.

One of the reasons for the Fund's strong financial position is because the Fund operates more or less along traditional actuarial lines. The exact contribution from each employer is based on the number of workers employed by the firm and an evaluation of the safety record of the particular industry. In this way premiums are closely linked to the safety risk of the industry, although not to the safety record of the individual firm as would be the case with pure insurance. Firms in the mining and building industries may also reinsure themselves with two particular mutual associations, provided that the contract is approved by the Compensation Fund. Currently, premiums range from R1.13 per R100 earned to R8 per R100 earned across 25 job categories. There may be some room for more private sector provision as these rates are considered expensive and the private sector reckons it can offer premiums that are 25 per cent cheaper (Mittner 1998). Non-compliance is also a problem, costing the fund in excess of R25 million per year (Mittner 1998).

7. Private Provision for Occupational Disability Insurance

There appears to be no compelling efficiency reason why insurance against occupational injury and disease can not be provided by the private market. Firstly, there is a demand for insurance. As noted above, firms, rather than face the risk of

high damage claims from employees, prefer the certainty of premiums. Secondly, adverse selection and moral hazard appear to be problems that can be overcome. As regards adverse selection, it is likely that insurance funds would attract higher risk firms - some industries such as mining are systematically more dangerous than others, while some individual firms are more negligent than others. But, by risk-rating industries, so that the more dangerous industries pay higher premiums, and increasing the contributions of industries that claim frequently, this problem can be reduced. An element of moral hazard that is of concern is that membership of the Fund may discourage firms from taking the necessary preventative steps to avoid accidents, such as providing the safest working conditions. This can be overcome through risk-rating and further reduced through stricter monitoring of compliance with regulation regarding the safety of the workplace. Another problematic element of moral hazard, common in Western Europe, is that firms often claim workman's compensation for healthy workers whom they intend to retrench because the benefits provided are more generous than unemployment benefits. Stricter evaluation procedures would reduce this practice.

Private provision of disability insurance is already being practised, to a degree, through the two mutual associations. Even the insurance mechanism used by the Compensation Fund resembles that of actuarial insurance with contributions dependent on the risk-rating of the industry and the employee payroll. Unlike in the case of unemployment insurance, relatively precise actuarial estimates can be made of the risk of disability for workers in different industries. Consequently, private insurance firms can set affordable premiums, correspondent to risk. The private financing of disability insurance is, thus, less problematic than in the case of

unemployment insurance. One problem that the Compensation Fund does face, though, is the problem of uncertainty: it cannot protect occupational disability pensions from erosion by inflation because occupational pensions are set at a fixed percentage of prior earnings.

Thus, there is no need for the state to provide insurance itself. Its only necessary role is to legislate compulsory membership and monitor the management of the Fund. Through compulsory contributions, employers are spared the costs of claims against them and workers are guaranteed compensation if the eventuality of disability or injury arises at work. In this way compulsory membership also helps to overcome the unequal power of workers in relation to firms.

8. Conclusion

It would appear that social insurance for work-related disability and disease under COIDA is meeting the needs of most working people rather well. Benefits are high relative to earnings and the range of conditions and diseases covered is adequate. However, the system still relies heavily on the compliance of the employer whose responsibility it is to initiate claims proceedings. Most importantly, there are large groups of workers who are excluded from membership. The Fund is in a fairly sound financial position, though, and as protection for most workers against the contingency of occupational disease and disability, COIDA operates efficiently.

CHAPTER 6

SOCIAL INSURANCE AGAINST ROAD ACCIDENTS

1. Introduction

Social security legislation makes special provision for those involved in road accidents. The Road Accident Fund is responsible for providing compensation to the victims of road accidents, and their dependants, in the form of adequate medical care and compensatory benefits. These payments are not social transfers, though, but are funded by a petrol levy paid by motor vehicle drivers. By paying the fuel levy, drivers are indemnified against any claims for compensation that may be made against them by victims of road accidents.

Currently, the Road Accident Fund is in financial crisis. It has been the subject of many investigations in recent years and various role players, interest groups and professionals have been involved in identifying problems and proposing solutions. But, despite the numerous consultations and publications, the government has failed to take action and now, more than four years later, the debate on the reform and future of the Fund is still continuing

The 1998 White Paper on the Road Accident Fund contains some of the most recent policy proposals and signals a new approach to compensation. Recognising the socio-economic realities of South African society and the pressing constraint on public spending, the White Paper emphasises the need for “a transition from a delict-based compensatory system to a system of affordable state benefits” (Department of Transport 1998: Preface). Thus, there is a shift in emphasis from the objective of

income maintenance that underlies a compensatory system to the provision of a safety net of benefits for victims. This will become clearer as the different elements of the White Paper's proposals are examined later in this chapter¹¹.

2. The Historical Background

The Road Accident Fund as it is currently structured was established relatively recently in 1996, but compensation systems for motor vehicle accidents have been in operation in South Africa since the 1940's¹². Some of the most dramatic legislative changes occurred in the mid-1980's when the fuel levy was first introduced and proposals are currently on the table for a further reform of the legislation.

In 1942, the Motor Vehicle Assurance Act 29 legislated compulsory motor vehicle insurance so that victims, in particular pedestrians, could receive some compensation for injuries sustained in road accidents. This insurance was provided by a number of private companies that charged statutory annual premiums. However, the revenue soon proved insufficient to cover claims, several companies were liquidated and in 1965, the Motor Vehicle Accident Fund (MVA) was established to act as re-insurer of companies who undertook compulsory MVA insurance. Then, in 1986 the funding mechanism and legal base of the system changed radically. With the introduction of the Motor Vehicle Accidents Act, annual premiums were replaced by a fuel levy. A

¹¹ Much of the analysis in this chapter focuses on the proposals contained in the White Paper on the Road Accident Fund. However, it must be borne in mind that these are merely recommendations that are currently under revision by the Road Accident Fund Commission.

¹² See Roux (1998: 1) for a useful summary of these systems.

system was also introduced whereby designated insurance companies acted as agents for the MVA Fund to manage and settle claims. In 1989, the system was extended to the former independent homelands of Transkei, Bophuthatswana, Venda and Ciskei under the Multilateral Motor Vehicle Accidents Fund Act. Then, from 1993 to 1997, the agency system was slowly phased out so that now all claims are handled and settled by a single Road Accident Fund.

The establishment of the Road Accident Fund and the accompanying changes in the management of compulsory motor vehicle insurance have not secured the Fund's financial position and in the last four years there have been many proposals for change.

The First Draft White Paper was published in May 1996 and aimed at providing sustainable solutions to the problems facing the Fund. One of its chief recommendations, namely that there be a system of no-fault compensation, was rejected by many stakeholders leading to the drafting of a Second Draft White Paper in April 1997 which proposed a hybrid of fault and no-fault compensation. Following further criticism, an independent Special Advisor was appointed to evaluate the viability of the proposals contained in the White Paper resulting in consultations over a revised Draft White Paper in October 1997 and, eventually, the final draft in December 1997. Further criticism necessitated the appointment of the Road Accident Fund Commission in May 1999 to "find a long-term and sustainable form of settlement for victims of road crashes" (Moyle 1999: 2) and, though initially scheduled to report before March 2000, has been permitted to extend the period of investigation indefinitely (Republic of South Africa 2000b: Section 1-5).

3. A Theoretical Perspective on the Road Accident Fund

The inclusion of the Road Accident Fund as a social insurance programme is easy to overlook. It is not a Fund that is linked to employment via pay-roll taxes, as are other forms of social insurance. However, on closer inspection, it can be seen to contain many elements of social insurance. The social nature of the Road Accident Fund is evident in the fact that obligatory contributions are paid by all road users and that benefits are available to almost anyone injured in a road accident.

The legal base of the Road Accident Fund is similar to that of insurance against occupational injury and disease (discussed in Chapter 5). Each road user is obliged to pay a contribution that insures him against potential claims for compensation by victims of road accidents in which the road user was at fault. The contribution is paid indirectly in the form of a fuel levy on petrol or diesel. This contribution indemnifies the driver or owner of a motor vehicle against any liability for any bodily harm caused to another person in a road accident. Because each road user pays the same levy, regardless of his individual risk of causing an accident, risks are pooled and more reckless drivers tend to cross-subsidise less reckless drivers. Road accident victims pay no contributions, but are entitled to compensation for medical expenses and loss of earnings without having to prosecute the wrongdoer under common law. The respective degrees of fault of the victim and the wrongdoer are carefully determined so that the victim's claim is reduced by the extent to which he is to blame for the accident.

From the victim's point of view, applying to the Road Accident Fund is preferable to filing claims under common law. Under common law, a road accident victim would

have the right to sue the wrongdoer for his medical expenses, loss of earnings and general damages. Compensation would be awarded based on the apportionment of blame in a judicial court. However, he runs the risk that the defendant may not have sufficient personal funds to provide adequate compensation. There may be a long interim period before the claim is settled during which he receives no income. He may not have sufficient understanding of the medical and legal issues involved or be able to obtain a lawyer with the expertise necessary to make an effective case. The high legal costs of lawsuits may be socially inefficient. From the driver's point of view, the fuel levy charged on his petrol consumption functions as an insurance premium to insure him against potentially costly damage claims from victims.

Unlike compensation for occupational injury and disease, the Road Accident Fund does not operate according to the principle of "no fault compensation". The victim cannot claim full compensation, regardless of his own negligence. Rather the size of his claim is reduced by the degree to which he is to blame for the accident. Thus, although the victim sacrifices his common law right to sue for damages, he is not guaranteed full compensation for his condition. He may only resort to a common law claim for compensation in cases where benefits are capped. Thus, road accident insurance is most concerned with maintaining the income of the driver, protecting him against high claims. It is more limited in the extent to which it protects a victim against a fall in income resulting from a road accident, even though previous earnings are taken into consideration in determining the monthly benefit. Where it does protect the victim, as mentioned above, is in cases where injuries and compensation would otherwise not be paid, such as when the wrongdoer cannot afford to pay compensation.

From a theoretical perspective, the rationale for a Road Accident Fund is clear. It eliminates adverse selection, but does not encourage moral hazard. Although it could theoretically be argued that the combination of a premium (fuel levy) that is not risk-rated and compensation that is guaranteed may encourage more reckless driving behaviour, the high psychic costs associated with accidents virtually eliminate this possibility. Drivers are not more likely to cause accidents simply because the financial costs (and then only of bodily harm) are removed. Moreover, the benefits of claims often do not accrue to the person who pays the premiums. Thus, the problem of moral hazard is of little concern.

Compulsory premium contributions to the Fund through the fuel levy also eliminate any adverse selection. If contributions were voluntary, many road users may choose not to pay the premium (even though, in theory, most rational individuals should prefer the certainty of premiums to the risk of high damage claims). Uninsured road users will most likely not be able to afford to compensate victims for both medical expenses and loss of income, especially in the case of permanently and severely disabled persons. Consequently, victims would not receive due benefits. Thus, compulsory contributions eliminate the problem of adverse selection and ensure victims of some compensation. The role of the state is to legislate the payment of compulsory contributions through the fuel levy. This is cost-effective because it eliminates the need to police payments and ensures that all contributions are paid.

For the Fund to operate effectively, the premium (fuel levy) does, however, have to be set at a high enough level to match average risk. One of the reasons why the Road

Accident Fund is in financial difficulty because there is little link between the value of contributions and the value of payments (i.e. the link between fund income and expenditure is broken). Social insurance for unemployment, occupational disability or retirement provides compensation for a loss of earnings by requiring a contribution linked to earnings. Thus, there is a clear link between contribution and benefit. Although this certainly does not ensure financial sustainability, it does establish some relationship: as income rises, premiums increase and potential benefits increase. With road accident insurance, though, contributions based on fuel consumption must compensate for a loss of earnings and medical costs. Some link is evident in that those who travel further are at a higher risk of causing accidents, consume more fuel and therefore pay higher premiums. However, the premium does not increase as the number of passengers being carried increases so that a minibus full of passengers pays the same fuel levy as a minibus with a single driver. However, in the event of an accident, compensation required could be much higher in the case of the full minibus, creating an imbalance between Fund income and potential expenditure. Caps on passenger benefits are used to contain some of this expenditure.

4. The Financial Position of the Road Accident Fund

Some analysts are of the opinion that the financial problems of the Road Accident Fund date back as far as the mid-1960's (Joffe 1997: Section 1.1). It was then that the insurance industry, which was providing third party insurance, was refused permission by the government to increase premiums and government assumed responsibility for compensating victims of road accidents through the establishment of the Motor Vehicle Accident Fund (Joffe 1997: Section 1.1). Finances deteriorated in

the mid-1980's when the fuel levy was not adjusted to keep pace with inflation and fund expenditure outstripped income from the fuel levy (Moyle 1999). In 1999, the Road Accident Fund ran an accumulated deficit of R9.16 billion (Road Accident Fund 2000: 3). The deficit had been growing by almost R1 billion per annum for many years so that between 1993 and 1997, for example, the undiscounted deficit more than doubled from R3 billion to R7.2 billion (Department of Transport 1998: Chapter 1 Section 1). If a reform of the existing Fund is not undertaken, it is estimated that there may well be a deficit of R39.3 billion by 2008 (Department of Transport 1998: Chapter 2, section 9).

In order to avert this grim scenario, but having realised that drastic and immediate savings are not possible, the government proposes to " 'ringfence the past' and 'manage the future' by drawing a distinction between an 'Old Fund' and a 'New Fund' " (Department of Transport 1998: Chapter 2, section 9.3). The Old Fund will consist of the assets and liabilities of the Road Accident Fund prior to 30 April 1998, whilst the levy income and liabilities arising from 1 May 1998 will accrue to the New Fund. The intention is to keep the New Fund solvent by reducing current levels of expenditure by about 18 per cent (Department of Transport 1998: Chapter 2, section 9.3). Exactly how this reduction is to be achieved will be examined in more detail in section 5.2. In addition, the deficit of the Old Fund will have to be dealt with, otherwise it will double every five years (Department of Transport 1998: Chapter 2, section 9.3).

5. Challenges facing the Road Accident Fund

The current financial predicament can be attributed to a number of factors, both on the income and expenditure sides of the balance sheet.

5.1 Inadequate Revenue

The root cause of the expanding deficit is the inadequate premium, in the form of the fuel levy, which has been paid for most of the Road Accident Fund's existence. The increases in the fuel levy have failed to keep pace with inflation especially in the (inflationary) mid-1980's and throughout the 1990's, contributing to the fall of real revenue over time and consequent outstripping of Fund revenue by Fund expenditure. In Joffe's investigation into the Road Accident Fund in 1997, he found that the current premium was only 40 per cent of what was needed to finance annual expenditure (Joffe 1997: section 4.3). Consequently, the 1997 fuel levy of 10.5 cents per litre on petrol and 6.8 cents per litre on diesel could only provide sufficient income for less than half the value of the claims awarded. At the time, the elimination of the Fund's deficit by 2002/3, in addition to meeting annual claims, would have required a petrol levy increase to at least 60 cents per litre (Robertson 1997: 1).

In order to remedy the financial position of the Fund, Joffe suggests a very large once-off increase in the levy followed by annual increases that at least keep pace with inflation (Joffe 1997: section 7.1). The White Paper (Department of Transport 1998: Chapter 2, section 1), taking into consideration forecasts of future claims values, investment returns and fuel volumes to be sold, proposes a more modest levy increase of 9 per cent per annum (Department of Transport 1998: Chapter 2, section 9.1).

Given these assumptions, a reduction of 18 per cent in current expenditure would still be required to keep the Fund solvent. Thus, the government does not appear willing to reduce the deficit by increasing fuel levies and will attempt to improve the financial sustainability of the Fund by reducing expenditure.

5.2 High Level of Expenditure

The following table shows a breakdown of the Road Accident Fund's annual expenditure. In 1997 (see Table 5.1), 18.3 per cent of total expenditure was spent on medical expenses, 19.3 per cent on loss of earnings, 13.2 per cent on loss of support for the dependants of a deceased breadwinner, 28.7 per cent on general damages and 20.2 per cent on settlement costs. The sections that follow will account for the relative share of total expenditure of each of these items.

Table 5.1 Composition of Road Accident Fund Expenditure, 1997

Compensation	R million	Percentage of Total Expenditure
Medical Expenses	223.8	18.3
Loss of Earnings	237.1	19.3
Loss of Support	161.6	13.2
Funeral Costs	4.2	0.3
General Damages	351.4	28.7
Settlement Costs	247.6	20.2

Total	1225.7	100.0
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Source: White Paper on the Road Accident Fund (Department of Transport 1998:

Chapter 1, section 2)

5.2.1 Settlement Costs

Of great concern is the high proportion of resources devoted to the settlement of claims, in other words, to proving entitlement to benefits and determining the value of compensation. Absorbing more than a fifth of total claims expenditure, it is an important contributor to the precarious financial position of the Road Accident Fund. In 1998 (see Table 5.1), settlement costs amounted to R247.6 million. It is the second largest single expenditure item, absorbing more financial resources than any particular category of compensation. This suggests that the claims and settlement procedures are inefficient – there is a very high ratio of settlement costs to compensation expenditure.

Most settlement costs arise from legal fees paid to attorneys and advocates, who assist claimants and the Road Accident Fund in the processing of claims, but also include payment to other professional experts, such medical doctors, accident investigators and actuaries.

5.2.2.1 Legal Fees

Settlement cost inefficiencies arise not so much from cumbersome administration within the Road Accident Fund as from the very litigious environment in which the RAF operates. A breakdown of the settlement costs paid to the various external

experts, in table 5.2, shows that in 1998 at least 76 per cent of settlement costs were spent on legal fees.

Table 5.2: Settlement Costs, 1997

	R million	Percentage of Total Settlement Costs
Attorney	162.0	65.4
Advocate	26.2	10.6
Medical Expert	41.3	16.7
Investigator	8.1	3.3
Actuary	4.9	2.0
Other Experts	3.9	1.6
Sundry	1.1	0.4
Total	247.6	100

Source: White Paper on the Road Accident Fund (Department of Transport 1998: Chapter 1, section 2)

Moreover, total legal costs for the settlement of claims are in fact even higher than reflected in this table. The entries above reflect party-to-party costs (the costs arising between lawyers from both parties in settling the claim) for which the Road Accident Fund compensates the claimant. However, attorneys usually offer the claimant a more comprehensive range of services than those compensated for by the Fund. These additional attorney-client costs are borne by the claimant and may be as much as a further 10 per cent of the claims paid (Department of Transport 1998: Chapter 1, section 3). Attorney-client costs are deducted from the compensation paid to the

claimant with the result that, in many cases, the claimant receives less than 70 per cent of the RAF's claims expenditure (Department of Transport 1998: Chapter 1, section 2). There is also evidence that there has been some abuse of attorney-client relations and monies that rightfully belong to the victims of road accidents have been misappropriated by corrupt legal professionals (Moyle 1999: 2).

High legal costs are one reason why proposals for a system of no-fault compensation have received much support from some quarters (see section 6.3.3).

5.2.2.2 Settlement Delays

Not only does the settlement of claims involve large financial costs, but there are long delays in their resolution. On average, claims are settled between 34 and 46 months after the accident (Roux 1998: 4). According to the Department of Transport (1998: Chapter 1, section 2), this is partly due to delays of between 18 and 36 months in the submission of claims and evidence. The remainder represents the time taken by the Road Accident Fund to assess the validity, merits (respective degrees of fault) and quantum (value) of the claims.

The White Paper contains some proposals to reduce settlement costs and settlement delays. Among these is the proposal that the Magistrates' Courts, rather than only the High Courts, be granted jurisdiction to hear disputes on the merits of cases. It is an attempt to ease the large High Court backlog of cases and speed up the settlement of claims -- about 50 per cent of high court cases are believed to be Road Accident Fund-related (Road Accident Fund 1998). It is also recommended that a special tariff for Road Accident Fund litigation be prepared (Department of Transport 1998:

Chapter 2, section 10.1) to combat the trend where attorneys charge clients fees higher than those reimbursed by the Fund. Another proposal is that an independent Tribunal operating on an inquisitorial basis be introduced prior to litigation (Joffe 1997: 4-6). It is not clear to what extent the findings of such a Tribunal would be binding. In a similar vein, a pilot project launched in the Western Cape in 1998 used independent arbitrators rather than the courts to resolve disputed claims (Road Accident Fund 1998). The expectation is that arbitration will have lower settlement costs, reduce the length of time taken to settle disputed claims and help alleviate the High Court backlog. No doubt, any simplification of the claims procedure would help to reduce costs and minimise settlement delays.

5.2.2 Medical Expenses

In the 1998 financial year, R223.8 million rand or 18.3 per cent of Fund expenditure was devoted to compensation for medical expenses (Department of Transport 1998: Chapter 1, section 2). These figures reflect reimbursements for all actual medical costs incurred as a result of accidents, including on-going medical care or future medical interventions that are needed after the settlement of the initial claim and that result from the accident. Medical expenses are reimbursed provided that claims exceed a threshold of R500 as the settlement costs of smaller claims would exceed the benefits provided. Compensation is subject to the apportionment of fault.

Depending on the preferences of the victim, future medical expenses can be reimbursed either by way of a cash lump sum at the time of settlement, by an undertaking by the Road Accident Fund to pay expenses as they are incurred in the

future or by a combination of a lump sum and an undertaking. The Road Accident Fund intends to make progressively more use of such undertakings as it finds that victims tend to dissipate the cash lump sum and ultimately not utilise awards for their intended purpose. Once-off cash settlements will be reserved for cases where the need for medical treatment is expected to be of short duration and the costs involved are relatively small.

Benefits are structured so as to provide for health care at the standardised rates of public hospitals and clinics. If a victim demands service from an alternative provider, for example a private hospital, the Road Accident Fund's liability will be limited to the cost of treatment at standardised rates. The Fund may have the influence to negotiate favourable arrangements with health care providers. This may not be in the best interests of the victim who prefers to use his own service provider, though, as it will most likely cause a greater divergence between his medical bills and the fees expenses reimbursed by the Road Accident Fund.

Over time, compensation for medical expenses has increased dramatically. This is in large part due to the high rate of medical inflation, but another driving force behind medical expenses is the cost of the examination of road accident victims by medical professionals to determine the degree of permanent impairment. Indeed, the White Paper notes that "the current practice of obtaining multiple expert and medical opinions ... is wasteful (or inefficient) and results in highly subjective, operator (assessor) dependent, and often conflicting reports" (Department of Transport 1998: Appendix D). Standardised guidelines for the assessment of medical evidence and the use of designated assessors would cut costs, reduce conflict and speed up settlement

time. Consequently, the White Paper proposes that the degree of impairment be determined according to the American Medical Association's (AMA) guidelines, the change in the victim's ability to meet the demands of his occupation be measured with reference to the International Standard Classification of Occupations (ISCO-88) and a schedule of standardised tariffs for assessments be published (Department of Transport 1998: Chapter 2, Section 10.2 and Appendix D).

5.2.3 Compensation for Loss of Income and Catastrophic Impairment

The value of both the monthly temporary and permanent loss of income benefit are calculated according to the same formula. As they are intended to compensate for lost earnings, the amounts awarded depend on the severity of the disability and the apportionment of fault, and are based on pre-accident income. The monthly benefit is calculated as follows:

$$\text{Monthly Benefit} = \text{Qualifying Earnings} \times \text{Percentage Permanent Disability}^{13} \times \\ \text{Percentage Merit of Claim.}$$

Qualifying Earnings are fixed at 75 per cent of deemed earnings¹⁴ and deemed earnings are taken to be at least R1 000 per month, regardless of actual earnings. The assessment of the percentage permanent disability (PPD) is performed by medical experts. The percentage merit of the claim measures how the benefits accruing to the

¹³ The PPD is also often referred to as the Percentage Permanent Impairment (PPI).

¹⁴ Deemed Earnings are taken to be the higher of actual monthly earnings at the time of the accident and the average actual monthly earnings over the preceding three years.

victim are reduced by the apportionment of blame. For example, 80 per cent merit means that the claimant is 20 per cent to blame for the accident. The monthly benefit is capped at R3 500, a level that is sufficient to cover the level of monthly benefit that might be claimed by about 75 per cent of the population (Community Agency for Social Enquiry 1998: 38). Those who earn above this ceiling can obtain some form of private cover, and are assumed to have the means to do so. Despite the cap, there is a rather skew distribution of claims as the 7 per cent of claims at the upper end of the income spectrum account for 62 per cent of the value of loss of earnings payments made (Department of Transport 1998: Chapter 2, section 11.3). The loss of income benefit disregards the victim's potential future career path and so those rendered disabled at the start of their income-earning trajectory, i.e. when they are relatively young, are not entitled to progressively higher benefits as time goes by.

After at least one month of incapacity, a temporary loss of income benefit may be applied for. If the disability persists, this may be converted into a permanent loss of income benefit, provided that there is a minimum of ten per cent permanent disability.

A criticism that was levied against the compensation for occupational injury and disease (COIDA) legislation in Chapter 5 can also be brought against the Road Accident Fund. It can be argued that compensation should not only be calculated according to loss of earnings and objective disability, but the injury's effect on the victim's ability to find a job should be taken into consideration. It can be deduced from the fact that most road accident victims belong to the lower quintiles that their labour market position is rather insecure. A relatively small physical disability can

easily render them unemployable or place them in a “first-out” position. Thus, sufficient compensation is essential for lower income earners.

Provision is also made for the payment of a catastrophic permanent impairment benefit in cases of extreme impairment. This includes all forms of impairment where the PPD exceeds 55 per cent and takes into consideration the age of the victim so that younger victims are entitled to greater compensation. Thus, it is estimated that, without taking into consideration the merit of claims, benefits can range from R9 938 for someone older than 80 years with 55 per cent impairment to R120 000 for a minor with 100 per cent disability (Department of Transport 1998: Chapter2, section 11.5).

5.2.4 Loss of Support Benefit

The loss of support benefit (or dependant’s benefit) provides income to the deceased victim’s dependants, i.e. surviving spouse, children, and dependent parents. This benefit is also based on the Qualifying Earnings of the deceased breadwinner, but considers the income of the surviving spouse. A standard funeral benefit of R3 000 is also awarded.

For all practical purposes the loss of support benefit functions as a no-fault benefit. “If the other driver was only marginally at fault, the dependants of the deceased are entitled to compensation without apportionment of fault, however negligent, reckless, or intoxicated the deceased might have been” (Department of Transport 1998: Chapter 1, section 5). This does not reflect a consistent application of the principle of fault-based compensation. While compensation for medical expenses and loss of

income benefits are determined by the extent to which the victim is to blame for the accident, i.e. the “merit” of his claim, loss of support benefits are not. Consequently, the White Paper proposes that full fault be apportioned in the case of loss of support benefits, too. This will bring it in line with the principles according to which other Road Accident Fund benefits are allocated. However, this would be tantamount to placing the blame on the deceased/injured victim’s dependants when they had no part in the accident. It would erode its role as a social security instrument of income maintenance for the victim (and his family) in the face of an unforeseen event.

5.2.5 General Damages

Claims for general damages consume more financial resources than any other category of compensation. Defined as compensation for “pain and suffering, disfigurement, loss of amenities of life” and “a financial consolation for a non-financial loss” (Department of Transport 1998: Chapter 1, section 6), they account for R351.4 million per annum or more than 28 per cent of claims expenditure (Department of Transport 1998: Chapter 1, section 2). This figure is significantly higher than the R223.8 million spent on medical expenses and the R237.1 awarded to compensate for loss of earnings in 1998 (Department of Transport 1998: Chapter 1, section 2). Due to their high share of total expenditure and the fact that “non-financial losses” are, by definition, difficult to quantify, the first draft White Paper proposed that the payment of general damages should be abolished. Joffe (1997: section 7) suggests the modification of this proposal so that only victims whose quality of life has been severely curtailed will be entitled to general damages awards, and then subject to a cap.

5.3 Other Expenditure Issues

5.3.1 The High Accident Rate

The most fundamental factor influencing the Road Accident Fund's expenditure levels is South Africa's extremely high road accident rate. Every year there are about half a million road accidents, in which approximately 10 000 people are killed and 50 000 seriously injured (Roux 1998: 10). As less than one per cent of the total collisions reported are in the former independent homelands, it is likely that the actual incidence of accidents is even higher than reported figures (Roux 1998: 10). In a 1992 investigation, it was revealed that there were only a few countries, such as Egypt and Kenya, that had higher fatality rate per 100 000 vehicles than South Africa¹⁵. In recent years, the Road Accident Fund has become actively involved in strengthening the Department of Transport's efforts to reduce the number of road accidents by "investing" 2½ per cent of its fuel levy income in road safety measures with the expectation that this will result in fewer and smaller claims.

5.3.2 Benefit Caps

An area of contention is the range and level of the caps that are placed on benefits. Currently, there is a cap of R3 500 on loss of income benefits and a R25 000 cap on passenger benefits. Caps prevent the resources of the Road Accident Fund being

¹⁵ South Africa's rate of 181.83 per 100 000 motor vehicles per annum eclipses those of most European countries by a factor of nine (Roux 1998: 9).

swallowed up by the claims of a relatively few high-income earning individuals. They certainly effect a measure of redistribution and allow benefits to be directed to the poorer victims, i.e. to those who are unlikely to have any form of private cover.

The cap on passenger benefits is particularly controversial. Although pedestrian victims, and passengers of drivers who are not to blame for their accidents, are entitled to unlimited compensation, compensation awarded to victims who are passengers in the wrongdoer's vehicle is restricted to R25 000 (Department of Transport 1998: Chapter 1, section 3). Although it will increase the expenditure of the Fund by about 10 per cent, the White Paper proposes that the cap on passenger benefits be removed to bring it in line with pedestrian benefits (Department of Transport 1998: Chapter 2, section 13).

In his 1997 report, Joffe recommended the introduction of a range of caps on all benefits, as did the first draft White Paper (Joffe 1997: section 7.2). He justified his standpoint by arguing that "the public is paying a low premium and therefore it can only expect low benefits". The ethical problem, though, is that it is the drivers who benefit from lower premiums, but often the pedestrian passengers who bear the burden of reduced benefits. These victims will be further disadvantaged if they are forced to forego their common law right to sue for extra compensation (see section 6.3.3).

5.3.3 Proposals for No-fault Compensation

A major issue in the debate on the future of the Road Accident Fund is whether it should operate fully according to the principle of no-fault compensation (rather than the apportionment of blame). Currently, through the payment of the fuel levy, the wrongdoer is indemnified against most of the liability for loss or damage caused to another person in a road accident. The compensation paid out to the victim and the wrongdoer by the Fund is determined by their respective degrees of fault. In cases where the Road Accident Fund caps its compensation, such as passenger benefits, the victim can still lodge a common law claim for compensation against the wrongdoer for any loss suffered in excess of the Fund's statutory liability. Thus, in the case of capped benefits, the premium does not fully protect the driver against common law claims against him nor does it guarantee the victim compensation for any losses.

The first draft White Paper initially recommended that a system of no-fault compensation be introduced whereby the victim would forfeit his right to make any common law claim for additional compensation from the wrongdoer and in exchange receive guaranteed benefits regardless of the merit of the claim. The major benefit of a no-fault system would be to reduce settlement costs – most legal and expert fees would be eliminated. In addition, significant attorney-client costs could be done away with which, while not affecting the position of the fund, would increase the sum total of benefits flowing directly to victims. These proposals met with much criticism from the legal fraternity, however, who challenged it as being unconstitutional. The second draft White Paper subsequently recommended a hybrid of a fault and no-fault compensation system with certain caps.

If a system of no-fault compensation is introduced and the right to common law claims for excess damages is abolished, but the cap remains on passenger benefits, the question of how to handle excess losses arises. The White Paper acknowledges that “to deny innocent victims the right to claim the damages they have suffered in excess of the benefits they have received from the RAF would seem to be protecting the negligent driver at the expense of the innocent victim” (Department of Transport 1998: Chapter 2, section 12). On the other hand, leaving this common law right intact has serious implications for the financial position of individual drivers and the transportation sector (especially the taxi industry). Furthermore, the White Paper claims that a statutory precedent does exist for this abolition in the Compensation for Occupational Injury and Diseases Act (COIDA) of 1993 with respect to injuries and diseases contracted in the course of employment. However, the COIDA does not cap compensation for medical expenses the way the White Paper proposes to and has a much higher effective ceiling on income support benefits.

Despite these savings, and the fact that a system of no-fault compensation is highly desirable from a social point of view, it is unlikely that such a system is affordable (Joffe 1997: section 5). The increased expenditure on compensation would exceed the savings in settlement costs.

6. The Articulation between Road Accident Benefits and Other Social Security Programmes

The articulation between the Road Accident Fund’s monthly benefits and the state disability grant can be illustrated by three examples in which the qualifying earnings and percentage merit of the claimant are varied.

As the minimum percentage impairment required for eligibility for a state disability grant is 50 per cent disability, this is the figure used for illustrative purposes. A single disabled person with no alternative source of income receives the full disability grant of R540. If this person's disability arises from a road accident, he is eligible for a monthly benefit from the Road Accident Fund. If the victim is completely innocent of wrongdoing (i.e. 100% merit) and his pre-accident income is so low that deemed earnings are set at R1 000, the monthly benefit is the following:

$$\begin{aligned}\text{Monthly Benefit} &= \text{Qualifying Earnings} \times \text{PPD} \times \% \text{Merit} \\ &= \text{R}750 \times 50\% \times 100\% \\ &= \text{R}375.\end{aligned}$$

In this case, the individual still qualifies for a disability grant of R434 in addition to the Road Accident Fund monthly benefit¹⁶, resulting in a total income of R809. Thus, for a person who is unemployed or has a very low income prior to an accident, the monthly benefit, and effective income, is relatively low and they remain eligible for a relatively large disability grant.

If qualifying earnings are much higher, for example R2 000, and the claimant's percentage merit remains at 100%, the monthly benefit increases to R750.

$$\begin{aligned}\text{Monthly Benefit} &= \text{R}1\,500 \text{ (i.e. } 75\% \text{ of R}2\,000) \times 50\% \times 100\% \\ &= \text{R}750\end{aligned}$$

¹⁶ As explained in Chapter 1 and Chapter 9, the disability grant is proportionately reduced, according to a sliding scale, as income increases up until the exclusion level where no grant is paid. The formula for the calculation of the disability grant is given by 1.15 times the maximum grant minus half of income.

Such a person is still eligible for a disability grant of R246, bringing total income to R996. The higher one's income, the larger is the monthly benefit and smaller the disability grant. These two examples also show how the articulation between the monthly benefit of the Road Accident Fund and the disability grant results in a much smaller income differential between relatively wealthy and relatively poor victims than is the case prior to an accident. A partially disabled person with no pre-accident income receives a combined benefit of just over R800, while a partially disabled person with a pre-accident income of R2 000 receives a combined benefit that is slightly less than R1 000.

If the assumption of 100% merit is relaxed, eligibility for a disability grant will continue up to a much higher pre-accident income, provided that no provision has been made for private disability insurance. For example, a claim of 80 per cent merit on a pre-accident income of R1 000 or less reduces the monthly benefit to R300.

$$\begin{aligned}\text{Monthly Benefit} &= \text{R}750 \times 50\% \times 80\% \\ &= \text{R}300\end{aligned}$$

This person is also eligible for a disability grant of R471, bringing total income to R771. Thus, as the percentage merit falls, the monthly benefit decreases so that a larger disability grant is received, but total income is smaller.

Road accident victims older than 65 are no longer entitled to monthly benefits from the Road Accident Fund. This is because the monthly benefit aims to compensate for a loss of income. The only financial compensation they receive from the Fund is compensation for medical expenses. They are reliant on the state old age pension,

unless they managed to use some of their monthly benefit in previous years to contribute to a private pension.

Government has decided not to go ahead with the interim benefit scheme to support claimants awaiting the outcome of their applications that was initially proposed in the 1998 White Paper. Consequently, the question arises as to what relief these victims will receive while awaiting the settlement of their claims. Currently, they do receive some interim payments that are deducted from the total value of compensation when the claim is settled. It may be possible, though, to give some assistance to victims through social relief. However, social relief payments are only available for a much shorter period than the average amount of time taken to settle claims and are generally set at too low a level to meet the special needs of severely injured people.

Of substantial financial importance to the Road Accident Fund is the overlap between the contingencies covered by the Compensation for Occupational Injury and Diseases Act (COIDA) and those covered by the Road Accident Fund. COIDA makes provision for the payment of compensation to employees involved in road accidents, travelling in an employer's vehicle to or from work or in the carrying out of work-related duties, provided that the accident is caused by the negligence of a third party. These employees are also covered by Road Accident Fund legislation. The problem that arises is that victims often claim full and inclusive compensation from the Road Accident Fund, rather than from the Road Accident Fund and the Compensation Commissioner at the same time (Mohlala 1999). The official procedure is that the Road Accident Fund should wait for the Compensation Commissioner to make a final award before it makes its offer. However, the Fund often assesses claims long before

the Compensation Commissioner, prompting people to offer to waive their rights to claim from the Compensation Commissioner with the result that the Road Accident Fund pays all costs. This is not according to established procedures, however, and processes should be strictly monitored to make sure that this does not occur. Compensation from COIDA should be paid first.

7. Conclusion

Clearly, there are two main tasks that now face policy-makers with respect to the Road Accident Fund. First of all, they need to find a way to eliminate the existing deficit in the Fund. Secondly, and more importantly, they need to redesign elements of the Road Accident Fund to “achieve an affordable and stable system which will offer a reasonable set of benefits in the long term” (Joffe 1997: section 6.1). This chapter has drawn attention to how the financial problems of the Road Accident Fund arose through examining, among other issues, the inadequate fuel levy, high legal costs and the high accident rate. Furthermore, it has considered some of the key issues in the debate on the structure of benefits, such as the capping of benefits, the suitability of no-fault compensation and the articulation between the monthly benefit and other grants, highlighting the implications that these have for income maintenance at different income levels. It is expected that the much-awaited report of the Road Accident Fund Commission will give some clarity as to how government proposes to respond to these challenges.

PART TWO

SOCIAL ASSISTANCE

In South Africa, social assistance is still considered a privilege reserved for certain groups, rather than a right. Despite declared government commitments to improving the position of certain groups in society, there is no commitment to providing a minimum standard of living for the broad mass of the population. Social assistance programmes in South Africa focus on those who are cannot be active on the labour market either due to their stage in the life-cycle or due to a disease or disability that excludes them from labour market participation. Even those who fall into specified and targeted vulnerable categories have their benefits subjected to a means test. Thus, assistance benefits have a residual character, offering a minimum that is unrelated to the recipient's accustomed standard of living. Moreover, there is no income support for the unemployed.

Part Two examines the different social assistance programmes of the South African social security system. Chapter 7 commences with an analysis of the processes by which transfers are funded and administered and highlights trends in social assistance expenditure. Chapter 8 looks at the old age pension that provides an income in the non-active aged period of the life-cycle. Chapter 9 examines assistance programmes for the contingency of disability, such as the disability grant and care-dependency grant. Chapter 10 looks at programmes designed to improve the security of young children through awarding grants, such as the child support grant, to their care-givers.

CHAPTER 7

THE FUNDING AND ADMINISTRATION OF SOCIAL ASSISTANCE

1. Introduction

In a constrained fiscal environment, there is a continuous tension between available funds and multiple needs. The Welfare function must compete against other expenditure priorities for a share of provincial budgets and, within the Welfare budget, there are trade-offs between expenditure on programmes that cater to different needs. The provision of an adequate safety net is a continual balancing act.

This chapter will examine the allocation of funds to the welfare budget for social assistance and the administration of these benefits. By examining recent figures on budgetary allocations, it will try to explain current allocations, trends in expenditure and discrepancies in provincial allocations to the welfare function. It will also consider the sources of future fiscal pressures.

2. The Funding of Social Assistance Grants

The provision of welfare is a concurrent function, meaning that responsibility is shared between national and provincial government levels. The national department is only responsible for “policy development, regulating entitlements and monitoring the system” (Department of Finance 1999b: Chapter 6.1), while the provinces are responsible for the implementation of policy, i.e. service delivery (Barberton 2000: 3).

Consequently, provision for social assistance expenditure is made on provincial budgets.

Each province's total budget consists of money received from the National Revenue Fund (referred to as the province's equitable share) and the province's own sources of revenue. Firstly, revenue from the National Revenue Fund is divided between national, provincial and local government levels in the so-called "vertical split" (Barborton 2000: 3). The National Department of Welfare receives its funding from the national equitable share. As the national department is only responsible for policy-making and monitoring, its share of the welfare budget is less than 1 per cent (Department of Finance 1999b: Chapter 6.1). Then, individual provincial shares are allocated between the provinces according to a formula that considers the provinces' demographic and economic profiles. The formula includes seven components - one each for education, health, social security, backlogs, economic activity, a basic share based on total population and an institutional component. Each component is broadly weighted in line with actual expenditure patterns. The final allocation to each province is open to some discretionary judgement, however. It is the province's responsibility to allocate its funds between the various departments and the different programmes within each department. Consequently, "...while the division of revenue between provinces takes into account the relative likely number of recipients of grants in the different provinces the absolute amount going to provinces for welfare does not explicitly take into account the likely number of beneficiaries in each province..." (Department of Finance 1998a: 39). Although the total available national expenditure is supposedly divided equitably between different provinces, this expenditure might not be sufficient to fund all social assistance transfers if provinces prioritise other

areas of expenditure. In special cases, conditional grants may be made by the national government to provincial governments for specific purposes, such as one made to improve the financial management of the social security system (Department of Finance 1999b: Appendix A.3). These are funded out of the national equitable share before provincial allocations. Table 7.1 below illustrates the division of revenue between different spheres of government, with estimates for the 1999/00 and 2000/01 fiscal years.

Table 7.1 Division of Revenue between National, Provincial and Local Government Levels, 1999/00 and 2000/01

	1999/00	2000/01
	R million	R million
National Equitable Share	78 733	81 100
National Departments	69 9712	72 739
Conditional Grants	8 761	8 361
Provincial Equitable Share	86 302	92 071
Local Government Equitable Share	1 673	2 480
Total to be Shared	166 708	175 652

Source: Department of Finance 1999b: Appendix A2

In the 19998/99 fiscal year, total provincial welfare expenditure was R18.4 billion. This was equal to just under 20 per cent of total provincial expenditure (the “provincial equitable share” in Table 7.1) and 9 per cent of total government

expenditure (the “total to be shared” in Table 7.1) (Department of Finance 1999b: Chapter 6.2).

At this point a note on terminology is useful: The terminology used by the Department of Finance to describe the different social welfare functions differs from that used in this thesis, and indeed that of many other writers. The Department uses the term "social security" when referring to social assistance, i.e. means-tested transfers. It uses the term "social assistance" to refer to government subsidies to welfare-orientated non-governmental organisations to, for example, fund the employment of social workers. There is agreement on the use of the term “social welfare services” which is taken to mean the provision of welfare services, including institutional care, by provincial governments. This chapter will continue to employ the definitions and terminology used previously in this thesis.

The examination of the allocation of funds to provinces and programmes and the administration thereof reveal a number of features that will be examined in greater depth in this chapter, namely:

1. The dominance of social assistance expenditure on welfare budgets
2. The increasing expenditure and over-expenditure on assistance programmes
3. The appropriateness of provincial allocations to the welfare function
4. The expectations of future changes in expenditure
5. Fraud, corruption and administrative error
6. The division of responsibility for social assistance

3. The Dominance of Social Assistance Expenditure in Welfare Budgets

Social assistance expenditure clearly dominates provincial welfare budgets, commanding 91 per cent of available resources (See Table 7.2). This is compared to 4 per cent spent on subsidies to non-governmental organisations and 2.8 per cent devoted to the provision of social welfare services.

Table 7.2 Composition of Provincial Expenditure by Programme, 1995/96 and 1998/99

Programme	Expenditure 1995/96		Budgeted Expenditure 1998/99		Average Annual Change 1995/96-1999/99
	Per item (R million)	% of total expenditure	Per item (R million)	% of total expenditure	
Administration	704.0	5.0%	168.5	0.9%	-37.9%
Social Assistance	12 311.0	88.2%	16 800.0	91.1%	10.9%
NGO Subsidies	708.0	5.1%	781.9	4.2%	3.3%
Social Welfare Services	218.8	1.6%	513.8	2.8%	32.9%
Social Development	7.3	0.1%	72.4	0.4%	114.8%
Population Unit Welfare Facilities	6.2	Negligible	65.2	0.4%	119.3%
Auxiliary	1.1	Negligible	20.9	0.1%	165.1%

Programme	Expenditure 1995/96		Budgeted Expenditure 1998/99		Average Annual Change 1995/96- 1999/99
	Per item (R million)	% of total expenditure	Per item (R million)	% of total expenditure	
Total Provincial Expenditure	13 957.0	100%	18 434.8	100%	9.7%

Source: Adapted from Medium Term Expenditure Framework - Welfare 1998

(Department of Finance 1998a: 27)

This distribution has come under sharp criticism, especially from the social work sector. There are complaints that increases in the value and number of social assistance grants are increasingly crowding-out expenditure on social welfare services and social work posts.

In reality, though, this seems not to be the case. Although there was indeed a rapid increase in social assistance expenditure over the period 1995/96 to 1998/99, this was mainly as a result of the equalisation of the value of grants awarded to different race groups. This was a once-off increase and in future only gradual increases are expected as take-up rates improve. Moreover, it is predicted that between 1998/99 and 2001/02, social security will grow more slowly than other programmes, leading to a slight drop in its relative importance to 90.4 per cent (Department of Finance 1999b: Chapter 6.4).

A comparison of provincial expenditure on social assistance confirms that the percentage of total welfare expenditure devoted to social assistance has not increased that much since 1995. Indeed, Table 7.3 shows that the increases are smaller than in previous years and are driven by increases in only three provinces, namely the Eastern Cape (7.0%), KwaZulu-Natal (4.0%) and the Western Cape (5.0%). The increases in the Eastern Cape and KwaZulu-Natal can be ascribed to high poverty rates that necessitate a large number of pension and grants, a severe backlog of pension payments and a vast rural population that complicates penetration by social workers and welfare services.

Table 7.3 Elasticity of Social Assistance Expenditure with respect to Welfare Expenditure

Province	Average Annual Change in Welfare Expenditure (WE) (1995/96-1998/99)	Average Annual Change in % of Welfare Expenditure allocated to Social Assistance (SA) (1995/96-1997/98)	% Change in SA divided by % Change in WE¹⁷
Eastern Cape	12.2%	7.0%	0.57
Free State	10.2%	0.2%	0.02
Gauteng	6.6%	1.0%	0.15
KwaZuluNatal	10.1%	4.4%	0.40

¹⁷ This ratio cannot be calculated with accuracy as it compares changes over time periods with two different endpoints. It assumes that expenditure trends of 1998/99 will be similar to that of 1997/98.

Province	Average Annual Change in Welfare Expenditure (WE) (1995/96-1998/99)	Average Annual Change in % of Welfare Expenditure allocated to Social Assistance (SA) (1995/96-1997/98)	% Change in SA divided by % Change in WE¹⁸
Mpumalanga	13.4%	-4.7%	0.35
North West	9.9%	-1.7%	0.17
Northern Cape	2.5%	1.0%	0.40
Northern Province	15.2%	-0.7%	0.50
Western Cape	4.9%	5.0%	1.02
Total	9.9%	3.0%	0.31

Source: Calculated from Medium Term Expenditure Framework 1998 (Department of Finance 1998a: 30-31).

The increase in the Western Cape is puzzling. Indeed when calculating the elasticity of social assistance expenditure to increases in total welfare expenditure (see Table 7.3 column 4) it is the only province with a ratio greater than unity. In other words, it is the only province where the relative share of social assistance has increased in the provincial budget. The most likely explanation is that the relative increase of social assistance is the result of large-scale cutbacks on expenditure on subsidies to welfare institutions. Indeed, the Western Cape is the province best penetrated by welfare

¹⁸ This ratio cannot be calculated with accuracy as it compares changes over time periods with two different endpoints. It assumes that expenditure trends of 1998/99 will be similar to that of 1997/98.

services and it is the government's intention to reduce the extent of institutional care. In all other provinces, the budget share of social assistance remained stable or even fell.

In 1998 a shift in budgetary allocations was proposed to reduce the expenditure on social assistance to 80 per cent, releasing 20 per cent of the welfare budget to be spent on other welfare items. This proposal was referred to as the "80/20 principle" (Department of Finance 1998a: 9). It signalled a reorientation towards greater service delivery by the Department of Welfare, with an emphasis on programmes that are community-based and sustainable. It was hoped that this approach would eventually reduce the number of recipients in need of social assistance transfers, relieving pressure on state finances. This shift in emphasis provides an explanation for the growth in expenditure on social development in the mid- to late- 1990's by an average of 114.8 per cent per annum (Department of Finance 1998a: 27, see Table 7.2). In 1998/99, 72.4 million was allocated to the social development portfolio to fund "the transformation of expensive, unsustainable models of service delivery to community-based developmental models" (Department of Finance 1998a: 4) in a manner that empowers communities and individuals to become self-reliant. However, support for this 80/20 proposal was much stronger when it was introduced than it is now. The 80/20 target only seems within reach for Gauteng, which currently spends 81 per cent of its welfare budget on social assistance (Department of Finance 1999b: Chapter 6.8). The Western and Northern Cape are slowly approaching the target, but it seems out of reach for the remaining, poorer provinces, especially as expanding take-up of the child support grant increases the demand for social assistance expenditure.

Administration costs appear to have declined markedly by more than one third. However, this is a statistical illusion because since 1995/96 the administrative costs of each programme are no longer shown as a separate budget item under the heading "Administration", but have been incorporated into the budgets of the individual programmes. This could explain some of the relative increase in social assistance and other welfare expenditures.

A significant feature of welfare expenditure is the tiny fraction devoted to personnel expenditure. Across all programmes this is only about 4 per cent (Department of Finance 1998a: 27). On the one hand this reflects the small allocations to social work employment and institutional care. Understaffing is commonplace, many posts have been frozen and there is a need for retraining of personnel (Department of Finance 1998a: 10). On the other hand, low personnel expenditure means that the bulk of welfare expenditure flows directly to the targeted recipients with comparatively little opportunity for leakage to intermediaries. It begs the question, though, whether inadequate human capital is an important cause of some of the problems facing the Department of Welfare.

The dominance of social assistance expenditure on welfare budgets suggests that there is little scope to increase the share of welfare budgets allocated to social assistance. This would only be possible through an absolute increase in the total welfare budget. Even then, many would plead for an increased relative share for other welfare functions, such as social work positions or welfare services. This, however, would not necessarily result in a more equitable outcome because only a minority of South Africans, who live in institutions, would mainly benefit from this. The poorest,

especially in rural areas and townships, have little access to welfare institutions and services, and are arguably better reached through social assistance grants. Moreover it is the government's stated intention to cut expenditure on institutional care, e.g. old age homes and special schools, encouraging family or community care of individuals - something for which a larger budget for social grants would be of assistance.

4. Increasing Expenditure and Overexpenditure

In the first half of the 1990's expenditure on social welfare was the fastest-growing budgetary item (Haddad and Zeller 1997: 1). Total national and provincial welfare expenditure in South Africa grew from approximately R14 billion in 1995/96 to a budgeted R18.6 billion in 1998/99 (Department of Finance 1998a: 25). This is equivalent to an average annual increase of 9.9 per cent, made possible by an annual average economic growth rate increase of 10.4% (Department of Finance 1998a: 25) over the same period. However as the inflation rate averaged 6.8% (Department of Finance 1998a: 25) this does not represent much of a real increase in expenditure. Nominal welfare expenditure increases are also in line with the total national and provincial expenditure increase of 9.1 per cent (in nominal terms). Thus, the increase in aggregate welfare expenditure over the last five years has not been dramatic.

Table 7.4: Growth in Aggregate Welfare Expenditure, 1996/97 to 1998/99

Expenditure	1995/96	1996/97	1997/98	Budget 1998/99	Average Annual Change 1995/96-1998/99
	R billion	R billion	R billion	R billion	
Total Welfare Expenditure	14.0	16.1	17.6	18.6	9.9%
Total National and Provincial Expenditure	158.1	177.6	190.2	205.2	9.1%
Gross Domestic Product	497.3	556.2	613.0	669.0	10.4%
Consumer Price Index					6.8%

Source: Adapted from Medium Term Expenditure Framework 1998a (Department of Finance 1998a: 25).

4.1 Trends in Social Assistance Programme Expenditure

As social assistance accounts for more than 90 per cent of total welfare expenditure, it can be assumed that changes in (over)expenditure have been chiefly driven by changes in social assistance allocations.

An examination of the composition of programme expenditure, shown in Table 7.5, reveals that the social assistance budget is dominated by expenditure on old age pensions. Expenditure on care for the aged accounts for nearly 60 per cent of total grant expenditure (Department of Finance 1998a: 28). Although the total real amount of expenditure on the old age pension has increased, its share of total social assistance

expenditure has fallen since 1995/96 by seven percentage points. This decline reflects the growing importance of other budgetary items within the social assistance budget, in particular transfers to the disabled and administrative expenses.

Expenditure on transfers to the disabled has grown rapidly. This is both in terms of its relative importance, from 22 per cent to 26. per cent of social assistance expenditure, and in real terms, by an annual average of 17.4 per cent since 1995/96 (Department of Finance 1998a: 28). It is this budgetary item that is expected to drive much of the future social assistance expenditure increases.

Administrative expenses have undergone an apparent more than fifteen-fold increase. As was noted earlier, though, this merely reflects the fact that "administrative expenditure" is no longer shown as a separate item on the total welfare budget and the portion of administrative expenditure associated with social assistance is now reflected here.

Transfers aimed at children in poverty-stricken families have increased by about 9.8 per cent per annum since 1995/96. These transfers are reflected in the entry "child and family care" which represents expenditure both on the old child maintenance grants and the new child support grant. In real terms, the increase is not very substantial, but as take-up of the child support grant gains momentum, larger increases can be expected.

Although Social Relief of Distress appears to have increased remarkably by 76 per cent, the absolute allocation is still small at around 0.4 per cent of total social assistance expenditure.

Table 7.5: Change in Social Assistance Expenditure by Programme, 1995/96 to 1998/99

Transfer	Expenditure 1995/96		Expenditure 1998/99		Average Annual Change 1995/96 –1998/99
	R million	% of total	R million	% of total	
Administration	32.5	0.3%	502.7	3.0%	149.2%
Child and Family Care	1 427.7	11.6%	1 889.0	11.2%	9.8%
Care of the Aged	8 138.3	66.1%	9 969.6	59.3%	7.0%
Care of the Disabled	2 700.0	21.9%	4 371.5	26.0%	17.4%
Social Relief of Distress	12.4	0.1%	67.4	0.4%	76.0%
Total Social Assistance	12 310.9	100%	16 800.2	100%	10.9%

Source: Adapted from the Medium Term Expenditure Framework – Welfare (Department of Finance 1998a: 29).

Expenditure on grants has been complemented by a number of small once-off expenditures aimed at improving the delivery of transfers. In the past, these measures have included a R75 million allocation for the implementation of the Child Support Grant, allocations for the Inter-Ministerial Committee on the Transformation of the Child and Youth Care System (R20 million), two payments of R100 million to

improve social security information systems and a R50 million and R203 million allocation from the poverty alleviation fund (Department of Finance 1998a: 26). These costs are borne by the National Department of Welfare and are thus not reflected in the social assistance budget, as tabled above

4.2 Overexpenditure and Under-budgeting

Although the increases in welfare expenditure have not been great, it remains a matter of concern that Welfare has repeatedly overspent on its budget, running aggregate deficits of R232 million, R1.3 billion and R964 million in 1995/96, 1996/97 and 1997/98 respectively (Department of Finance 1998a: 26). This could be due to an underestimation of the amounts needed to perform welfare functions, i.e. an under-budgeting of the share of the provincial budget needed by the Department of Welfare. Or it could be due to administrative inefficiencies, i.e. overexpenditure within provincial welfare departments. Social assistance expenditure, although not the fastest growing budget programme, demands such a high proportion of the overall welfare budget that it is responsible for the bulk of this deficit.

The problem is most clear when one looks at the deficits on individual provincial budgets. In fact, it is only the Western Cape that did not show a budget deficit in the 1997/98 financial year. The Northern Cape ran a deficit in excess of 15 per cent of the 1997/98 voted amount. Most budgets for the following year were increased, taking into consideration the amount of previous expenditure so that there would be a tendency towards smaller deficits, if any.

The Department of Welfare ascribes the deficits in the social security budget to under-budgeting of the social security function caused by unreliable statistics on the number of beneficiaries that, in turn, led to the underestimation of the amounts of money required (Department of Welfare 1998a: 46). Indeed, this seems to explain the high deficits in the Northern Cape: the original budgetary allocation was far too low given the high poverty rate. In the 1998/99 budgets, adjustments were made to make provision for 6 per cent growth in expenditure and to include the impact of backlogs, increases in grant tariffs and the re-registration of beneficiaries (Department of Finance 1998a: 47). This should reduce the deficit in the next year, but also highlights another criticism of the management of the Welfare finances: budgeting tends to be done on "...an incremental basis, using figures from the previous year.." with little long-term planning (Department of Welfare 1996: Chapter 8).

If this overspending continues, the long-term sustainability of the social assistance schemes is going to prove problematic.

5. The Appropriateness of Provincial Welfare Allocations to Welfare

Need

Because all social assistance transfers are means-tested, one would expect there to be a correlation between per capita provincial expenditure on social assistance and poverty rates. However, this does not seem to be the case. Although social assistance expenditure does, in general, increase as poverty rates increase (See Table 7.6 and

Figure 7.1¹⁹), the increase is not proportional and some provinces have exceptionally unusual levels of social assistance expenditure relative to their poverty rates. The Northern Cape is exceptional. It has the highest per capita social assistance expenditure, while its poverty rate is lower than most provinces at 55 per cent. This is especially noticeable when compared to Mpumalanga which has a higher poverty rate, but almost half the level of social assistance expenditure. The Northern Cape also has a high level of expenditure relative to poverty rates.

Table 7.6 Correlation between Per Capita Provincial Expenditure on Social Assistance and Poverty Rates, 1998/99

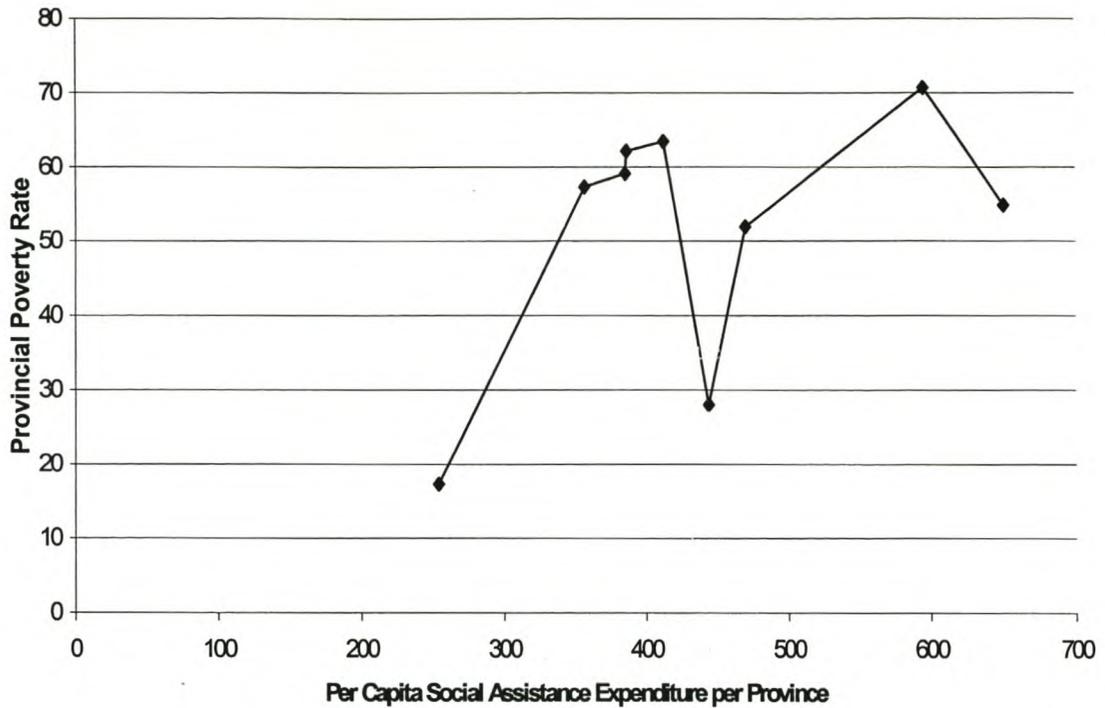
	Per capita Expenditure	Poverty Rate
Gauteng	254	17.3
Mpumalanga	357	57.3
Northern Province	386	59.1
North West	387	62.1
Free State	413	63.4
Western Cape	444	28.0
KwaZulu-Natal	470	51.9
Eastern Cape	596	70.7
Northern Cape	651	54.9

Source: Adapted from Medium Term Expenditure Framework – Welfare 1998

(Department of Finance 1998a: 32).

¹⁹ Both Table 7.6 and Figure 7.1 are arranged by increasing magnitude of per capita expenditure.

Figure 7.1 Correlation between Per Capita Provincial Social Assistance Expenditure and Poverty Rates, 1998/99



A large part of the explanation for these discrepancies lies in the way in which budgetary resources are allocated to provinces and then to the Welfare function. In the first place, social security and population are only two of seven components in the equitable share formula. Funds are allocated according to cumulative provincial need and the allocation does not explicitly take into account the welfare need or the likely number of beneficiaries. In the second place, after the equitable share allocation has been made, it is left to the discretion of the province to decide how much of its total budget is to be allocated to the welfare function. Consequently, Welfare competes with other provincial expenditure priorities, not always receiving the funds it needs, with the result that some of the poorer provinces' total welfare expenditure is not as high as is warranted by their poverty and demographic profile.

Another key factor is the take-up of grants. Although particular provinces may have higher poverty rates than others, take-up of benefits may be lower (due to lack of awareness, for example) with the result that smaller provincial allocations are required. Support for this hypothesis is found in the large difference in the correlation between expenditure on child and family grants and poverty rates and expenditure on old age pensions and poverty rates. The former shows little correlation while the latter, of which awareness is greater, shows a fairly strong correlation. The converse is also true. Provinces with low poverty rates may have a very high take-up rate and, consequently, require more expenditure. The take-up rate may be inflated by a number of non-eligible recipients of grants, such as “ghost pensioners” and double claimants or significant numbers of residents of other provinces collecting grants (see section 6 of this chapter).

A comparison of *changes* in total welfare expenditure per province indicates that money is starting to be spent in the provinces where it is most needed. The greatest average annual increases in welfare expenditure by province have occurred in the poorer provinces and in those with lower levels of service delivery in the past. Expenditure in the Northern Province, Mpumalanga and the Eastern Cape increased by 15.2, 13.4 and 12.2 per cent respectively over the period 1995/96 to 1998/99, while the historically better covered provinces experienced negative real growth in welfare expenditure (Department of Finance 1998a: 30). This not only shows that greater equity in welfare expenditure is being achieved, but suggests better targeting of resources and improves the prospects for poverty alleviation.

6. Future Expectations of Cost Increases

Now that racial parity in benefit levels has been achieved and coverage is extensive in the largest programme, i.e. old age pensions, the largest driving forces behind increased social assistance expenditure are much diminished. Future growth is mainly expected from the improved take-up of the child support grant and disability grant and any further extensions of coverage. The emergence of a more moderate expenditure growth will certainly be upset by the demands that HIV/AIDS will make on transfer payments.

Any cost increases are driven by a combination of a) increases in the level of transfers and b) increases in the number of beneficiaries:

a) Analysts at the Department of Finance predict that it is unlikely that the real value of grants will increase in the near future, providing a number of reasons for their conclusion (Department of Finance 1998a: 32). In the first place, grant values are already at a relatively high level. They are generous in relation to average income and the benefit level is higher than a per person poverty line set at the 40th percentile of the population. Secondly, the severe fiscal constraints faced by the government mean that social assistance must compete with priorities of other government departments as well as other areas of expenditure within Welfare, such as welfare services. Consequently, there is little room to increase the value of grants and any increases in social assistance expenditure are likely to result from increases in the number of beneficiaries.

b) Of course, future trends in beneficiary numbers cannot be predicted with certainty. Much will depend on demographic change, changes in income levels, changes in household structure and the extent to which fraudulent beneficiaries are eliminated. But as increases in the number of beneficiaries partly depend on the percentage of the target group receiving grants in previous years, current beneficiary numbers enable one to make some predictions. It is not expected that there will be much of an increase in the number of pension beneficiaries for those grants for which take-up is already very high.

The figures in Table 7.7 suggest that²⁰ the almost 3 per cent fall in the number of grants was driven mainly by a decline in the number of disability grants. There were declines of more than 10 per cent in evidence in the Eastern Cape, Gauteng and Northern Province According to the Budget Office (Department of Finance 1998a: 34), the decline in disability grants was purely as a result of data clean-up and the re-registration of recipients in order to eliminate those who were claiming grants fraudulently or who were incorrectly identified. It is expected that the number of beneficiaries of disability grants will increase in the future.

²⁰ Although in general it is not accurate to draw conclusions about trends in coverage based only on an analysis of the change over only one period, in this case the changes in these years appear to be representative of broader trends

Table 7.7: Number of Beneficiaries, 1998

Type of Grant	August 1998	Percentage Change (August 1997-August 1998)
Old Age Pension	1 774 094	1.8%
War Veterans Pension	9 938	-13.5%
Disability Grant	620 670	-17.8%
Grant-in-Aid	8 950	-7.9%
Parent Grant	172 244	4.1%
Child Grant	229 088	2.9%
Foster Care	44 990	4.8%
Care Dependency	12 413	225.4%
Child Support Grant	2 159	- ²¹
Total	2 874 546	-2.7%

Source: Adapted from Medium Term Expenditure Framework – Welfare 1998

(Department of Finance 1998a: 34)

The number of beneficiaries of old age grants increased by 1.8 per cent between August 1997 and August 1998. The largest increases occurred in the Western Cape, Northern Cape, KwaZulu-Natal and North West. The number of beneficiaries in the Eastern Cape and Northern Province fell, also largely due to data clean-up and the reregistration of only eligible beneficiaries.

The take-up of the child support grant following its introduction in April 1998 did not proceed as quickly as was initially expected so that by August 1998 only 2 159

beneficiaries or 0.7 per cent of the target population had registered (Department of Finance 1998a: 35). Consequently, it is expected that the number of beneficiaries will increase substantially in coming years.

The number of care-dependency grants paid out more than tripled. This may be the result of government's attempt to cut resources spent on institutional care, encouraging home-care of the handicapped, but is also surely due to increased awareness of this grant in townships and rural areas. If the care-dependency grant is extended to include HIV positive children, annual expenditure on this programme could increase to as much as R1.2 billion per annum (Barberton 2000: 18-19). This will be discussed in greater detail in Chapter 9.

In conclusion, the number of people receiving social grants is expected to grow relatively modestly in coming years, once the immediate catch-up of under-covered areas is complete, backlogs are addressed, the re-registration process finishes and living standards improve. The implementation of the child support grant, expansion of disability grants, and perhaps care-dependency grants, are expected to lead to the biggest increases in expenditure. But as far as the most expensive transfers are concerned, Van der Berg (1998: 42) concludes that there will be little cause for fiscal concern, provided that sufficient control is kept over provincial budgets.

²¹ The Child Support Grant was only introduced in April 1998.

7. Fraud, Corruption and Administrative Error

It is well known that there has been much abuse of the social security system, particularly of old age assistance. Corruption among government officials is rife, as is fraud by beneficiaries and administrative structures have been termed “cumbersome and costly” (Department of Welfare 1995: Chapter 8). The Committee for the Restructuring of Social Security estimated in 1997 that South Africa loses more than R1 billion per year to pension fraud or incompetence (Edmunds 1997).

To rout out ineligible recipients an extensive process of suspension and re-registration of beneficiaries was initiated in 1997. This was facilitated by the linking of SOCPENS (the social grants database) to PERSAL (the civil pensions database) and the UIF databases. In this way, any duplication of beneficiaries was revealed. It was found, for example, that 23 982 beneficiaries received payment from both SOCPEN and the civil pensions system and 1 015 people were beneficiaries of both the UIF and SOCPEN system (Department of Welfare 1998a: 39). Many people had been able to register themselves for grants for which they were not eligible, some collected grants under two different identities and some were registered in more than one province. Also common were “ghost pensioners”, i.e. deceased beneficiaries still receiving grants. As a result of these phenomena, Northern Province, for example, had an old age pensions take-up rate of 121.1 per cent (Department of Finance 1998a: 35). In some cases, maintenance grants were being received for more than two children and others received invalid combinations of grants. By 1998, the re-registration process had already effected net savings of about 30 per cent (Department of Finance 1998a: 38). For example, the suspension of maintenance grants for children older than 18 saved R11.3 million and the suspension of 15 167 expired temporary disability grants

another R2.1 million in 1997/98 (Department of Welfare 1998a: 32). Now, monthly reports on data discrepancies generated by SOCPENS are submitted to provinces for resolution.

Of concern, though, is that in some cases the methods employed to rout out ineligible beneficiaries sometimes run contrary to the very principle of social assistance. Whereas social assistance aims to provide a safety net to the poor, the suspension and re-registration process rendered thousands of very poor people more vulnerable than ever before. In February 1998, the Northern Province froze pension payment to 92 000 people, justifying their action by claims that at least two-thirds of the payments – an equivalent of R44.5 million per month - were going to “ghost pensioners” (Ratshitanga 1998). Indeed, 36 700 illegal recipients were found who had been costing the department R251 million per year (Ratshitanga 1998). However, in the process, many legitimate recipients were denied pensions. Some pensioners took their cases to court, successfully demanding back-payments with 15 per cent interest, but the potential for litigation was much greater as the freeze affected tens of thousands of eligible beneficiaries. The state was spared those costs simply because, as one pensioner put it, “the affected beneficiaries are a large group of poor, unsophisticated and often illiterate people who cannot effectively protect their own interests” (Ratshitanga 1998).

There are also long administrative delays in the processing of grant applications. In the interim, applicants are entitled to a small grant from the Social Relief for Distress programme, but many waiting periods exceed the maximum time for which Social Relief is usually paid out. In a survey by the Community Agency for Social Enquiry

(1999: 33), 46 per cent of respondents claimed to have waited between three and twelve months for their disability grant application to be processed and 21 per cent claimed to have waited more than one year. Only 27 per cent claimed to have received their grants within the stipulated three months.

There are also large backlogs in monthly payments. Staff shortages, a lack of staff motivation, problems with SOCPEN, suspension of payments during investigations of fraud and a lack of funds all slow down the processing of payments. The largest backlog in 1998 accumulated in the Eastern Cape with 45 245 such cases (Department of Finance 1998a: 31). However, an investigation by the Department of Finance (1998a: 37) found that that, except in the Eastern Cape where the backlog amounted to over R312 million, these backlogs did not constitute a major threat to sustainability.

8. The Division of Responsibility for Social Assistance

The Committee for the Restructuring of Social Security contends that many of the problems facing the welfare sector arise from the current province-based system of grant administration, which is described as “in crisis” (Edmunds 1997). Instead they propose a national delivery system so that all, no matter where they live, will receive the same treatment. A national system, they argue, will be easier to co-ordinate and reduce the potential for double claims and fraud. Currently, service delivery, i.e. grant administration, is the responsibility of provinces, but the national Department is responsible for policy, legislation and regulation, and the annual increase in the level of the grants.

In the first place, this leads to inconsistency across provinces in the way in which grants are paid out (Department of Welfare 1999). In some provinces grants are paid out by government employees and Welfare Departments. In other provinces, this responsibility lies with private companies that have been contracted to the Welfare Department for precisely this purpose. Grants can also be paid out at the Post Office or into beneficiaries' private bank accounts. Recipients living in institutional care may have their grants paid into the institution's bank account. Some may see this as flexibility on the part of the Department of Welfare in responding to different needs and preference. But, it may also raise administrative costs and complicate the application and receipt procedure.

Each province also decides independently on how grants will be reviewed. The review involves a re-application of the means test and an assessment of compliance with other eligibility criteria, such as age and state of health. The outcome will determine whether the value of the grant is increased, decreased or cancelled. All grants are reviewed at different times and intervals by each province (Department of Welfare 1999). In many provinces, the reality is that grants are never reviewed. This leads to many inconsistencies and varying incentives that eventually translate into inequalities in the way that benefits are administered.

The division of responsibility and budget allocation process for the funding of these different responsibilities may lead to "budget gaming" (Department of Finance 1999b: Chapter 6.16). Firstly, the equitable division of revenue between provinces does not mean that the mandate from the national level to pay grants to all who are eligible will be fully funded. This may result in pressure on provincial budgets. This, in turn

may contribute to the second problem, namely that the budget shortfalls will have to be made up by the central government. Because grant payments are ultimately entitlements against the central government, the government will cover the shortfalls. The assurance of a national bail-out could encourage administratively inefficient provincial departments to pass on the cost of mismanagement to the national government. Also, because budgetary allocations in a second year are largely determined by expenditure in the first year, any savings generated in social security may merely lead to reductions in budgetary allocations in following years, in which case there will be little incentive to save.

The division of responsibility has been under discussion for a lengthy period and there is now increasing support for greater centralisation of responsibility.

9. Conclusion

The foregoing analysis has revealed that South Africa's social assistance scheme can best be described as budget-driven: the generosity of benefits is not determined by the extent of need, but rather by what can be afforded. Consequently, it is essential that budgets are adhered to and administration is efficient so that maximum resources can be spent on poverty alleviation.

Despite the fact that grant equalisation has been achieved and accusations that social assistance is crowding-out expenditure on other programmes, social transfers will require ongoing expenditure. Unequal per capita expenditure across provinces and inadequate coverage of target populations mean that there is going to be increasing demand for social assistance expenditure, especially as awareness of grants improves.

Expenditure is expected to grow most in those provinces with large numbers of children qualifying for the child support grant, and also by an expansion of take-up of the disability grant and the care-dependency grant. Increases in grant levels are unlikely as they will be constrained by increases in beneficiary numbers. Given increasing demands for social assistance expenditure, the 80/20 target seems out of reach.

CHAPTER 8

SOCIAL ASSISTANCE IN OLD AGE

1. Introduction

The social old age pension is the chief social security measure used to alleviate poverty and smooth income in this dependent period of the life-cycle. It is assisted by other measures such as grant-in-aid transfers to the elderly who require full-time care. Not only is the social old age pension the fundamental form of social protection in old age, but it is vital in the poverty alleviation strategies of people of all ages in South African society. Indeed, pensions have been hailed as "the most effective social programme in targeting and reaching economically vulnerable groups" (Van der Berg 1997: 10, after Ardington and Lund, 1995, and Case and Deaton, 1996). The equalisation of pensions awarded to all race groups reduced poverty levels substantially and "pensioners have become comparatively wealthy members of poor communities" (Van der Berg 1997: 10). Households, and particularly rural households, with one or more pensioners as members are considerably better off than other households.

This chapter begins with an examination of the benefit structure and eligibility criteria of the old age pension. It then identifies particular fiscal and administrative concerns. Finally, consideration is given to the coverage by and take-up of benefits, and the implications thereof for poverty alleviation.

2. Benefits and Eligibility Criteria

2.1 The Benefits

All elderly South Africans are eligible for a social old age pension, provided that they fulfil the requirements of the means test. Up until 1993, the level of benefits varied across race groups and the means test discriminated by race. Now, eligible applicants of every race are entitled to an old age pension of R540 per month. Gender discrimination still exists in that women are eligible for a social pension from the age of 60 while men must wait until the age of 65. In addition to the monthly pension, beneficiaries are entitled to free medical care at provincial hospitals. Some pensioners receive a small War Veterans grant, set at a slightly higher level than the old age pension, but the number of recipients is dwindling as participants in the Korean Wars of the early 1950's were the last to qualify for War Veteran grants.

When compared to measures of income and wealth, it can be seen that the old age pension is set at a relatively high level. In 1998 the level of the social pension was equivalent to 34.3 per cent of per capita GDP (own calculation) – a high figure by international standards, especially considering that many countries require contributions to a national pension scheme before benefits can be paid out. The benefit level is also high when compared to wage levels. In 1997, when the old age pension was just under R500 per month, the average minimum wage was R1 800 per month, while many mineworkers earned less than R1 000 per month (Molebatsi 1998: 70-71). The effective value of the pension also differs from place to place within the country because of differences in purchasing power, especially when urban and rural areas are compared.

The social old age pension is not an entitlement granted universally to all those over a particular age, but is subject to a means test. The operation of the means test and its consequences have been discussed in detail in Chapters 2 and 3, but it is worth repeating some of the points that were made. It was noted that the means test is costly and time-consuming and that the difficulties of its administration are aggravated by the illiteracy of many applicants, large amounts of documentation, the difficulty of measuring income and imperfect information. The poverty trap created by the 50 per cent marginal rate of taxation is of particular concern as it creates disincentives to save or provide for retirement through private schemes and encourages the withdrawal of benefits before retirement and a preference for lump sum benefits over pensions.

2.2 A Universal Pension?

These factors, together with the fact that so few South Africans experience long uninterrupted periods of formal employment and merely a tiny percentage of those receives an occupational pension, have led to a call for the abolition of the means test in favour of a universal social old age pension. A universal pension may be more economically efficient than means testing, especially given the near-universal eligibility for at least some portion of the old age pension. It would lessen the administrative and fiscal burden of applying the means test, remove the perverse incentives outlined above and encourage private retirement provision for those who desire more resources in retirement than the social pension can offer (Van der Berg 1997: 13). It is also more likely that those who are currently eligible for a pension, but not taking it up, would be more likely to receive it. Indeed, the Mouton Committee,

the Smith Committee and the National Consultative Retirement Forum have all considered the universal grant.

A universal pension has its downside, too. It may be less distributionally progressive than the present social pension. In the first place, the means test, in addition to enabling targeting of the most needy and saving costs, allows a measure of income redistribution that would be eliminated under a universal pension where all the elderly receive pensions. Secondly, because life expectancy is higher among the more affluent, they will receive pensions for a longer period of time, effecting some redistribution in favour of the relatively well-off. There is even the possibility that people currently receiving the full pension would be made worse off if the level of pensions had to be lowered in order to finance a universal pension.

The fiscal implications of a universal pension are an important consideration. In 1996, it was estimated that if all the elderly received the maximum old age pension, it would cost the fiscus R11.7 billion opposed to the R8.7 billion it was costing with the application of the means test (Van der Merwe 1996: 431). Some of this R3 billion difference would be offset by reduced administration costs. Van der Berg holds that the some of the remainder could be clawed back through increased income tax collection by the removal of the old age rebate, the application of normal tax scales to pensioners and the reduction of some of the tax concessions for private retirement provision (Van der Berg 1997: 14). Thus, Van der Berg concludes that fiscal costs currently appear manageable. However, one also has to bear in mind that although the fiscal burden of a universal pension seems manageable now, as South Africa's population starts to age, a universal pension may become increasingly difficult to

sustain, especially if economic growth and tax capacity cannot keep pace. Also, it may not be too long before the income distribution amongst the elderly develops a different pattern as more and more black people retire with some private retirement provision (Van der Berg 1997: 11).

3. Financing and Fiscal Implications

There has been considerable debate on the financing of the social old age pension. At the moment it is funded from general revenue and distributed via provincial budgets – a mechanism that was found to be appropriate by the 1995 Smith Committee.

The pressure that the social old age pension places on fiscal resources does generate some concern, though, especially given the failure of the economy to meet economic growth targets and expand its tax capacity. Indeed, financing of social old age pensions is expected to require R12 billion by 2000/01 (South Africa, Department of Finance 1998b: 5.20). Certainly, this suggests that a higher level of old age pensions, and the introduction of universal pensions, seem fiscally unrealistic. Also, pressure to increase expenditure on other areas of social assistance, such as child support and care-dependency grants (see Chapters 9 and 10), severely constrains any expansion of social old age pensions.

Any attempts to equalise the qualifying ages of men and women will obviously have cost implications. Raising the qualifying age of women to 65 would effect savings of more than 25 per cent. But the Smith Committee rejected this proposal, although it had been a strong recommendation of the Mouton Commission. The reasons given were that women, having been historically excluded from formal employment, have

had less opportunity to contribute to retirement funds and that women's spending patterns have proved to contribute more to poverty alleviation than those of men (Smith Committee 1995: 41). The alternative of reducing men's retirement age is rendered impossible by fiscal constraints. Another option is to introduce incentives for the elderly to defer the commencement of pension benefits, such as increasing the value of the pension by a particular percentage for every year of deferment. This is already practised in the United States and Japan, but as the Smith Committee (1995: 42) pointed out, it is unlikely that potential pensioners have sufficient alternative resources to permit the luxury of deferring the commencement of retirement in South Africa.

An additional fiscal concern is the rising numbers of old people countrywide. The Smith Committee (1995: 39) identified two chief options to contain costs. One would be to keep the annual increase in pension levels lower than the inflation rate. Another option would be to raise the qualifying age. However, the Committee rejected both of these options because the first would erode the purchasing power of the pension, while the other would exclude needy individuals from benefits for a longer period. Another suggestion was to set the old age pension at a fixed percentage of GDP (Smith Committee 1995: 5), but this would make pensioners even more vulnerable to cyclical fluctuations. The option of reducing costs through tightening administration was also considered. This would involve, for example, administering the means test more frequently to exclude those who no longer qualify. However, it has to be carefully calculated whether the savings generated by this process justify the cost of frequent revision. Striving to eliminate corruption may be a better starting point (see Chapter 7).

Despite these concerns, many analysts are not too perturbed. Van der Berg (1997: 11) maintains that as long as the means test remains in place, eligibility criteria are enforced and benefit levels stabilise around their present levels, there is no real danger of seriously escalating fiscal burdens. Lipschitz, too, (in Van der Merwe 1996: 401) concludes that the number of elderly people will remain a small percentage of the population in the near future and, consequently, not constitute a major burden on the fiscus. There are a number of other factors that provide reason for optimism. Proper administration of the means test and cleaning of pensioner databases can eliminate ineligible beneficiaries and ensure that people receive the appropriate level of benefits. Improved access to occupational pensions may reduce the number of people reliant on social old age pensions. Eliminating fraud and corruption is a priority.

4. Coverage, Take-up and Poverty Alleviation

The White Paper on Social Welfare estimates that 80 per cent of the elderly population are covered by old age pensions, but notes that certain pockets of eligible people still do not receive grants (Department of Welfare 1996: 74)²². The Department of Welfare's approximation of coverage is confirmed by the estimates of other researchers. Van der Berg (1997: 10) calculates 75-80 per cent coverage and Van der Merwe (1996: 401) calculated 77 per cent based on 1993 data. Numbers generated by the social pensions database SOCPENS put the actual number of beneficiaries at just under 1.8 million in 1998 (Department of Finance 1998a: 34).

²²This figure means that 80 per cent of people eligible by age are receiving benefits. The take-up rate, i.e. the percentage of elderly people eligible by age and eligible in terms of the means test is a bit higher, as the means test effectively excludes the wealthier elderly.

The poverty-alleviating potential of social old age pensions goes well beyond these immediate recipients to reach about 7.7 million people (Van der Berg 1997: 10). The three-generational nature of many South African households means that every pensioner's income helps five other household members (Department of Welfare 1996: 74). Especially in families with unemployed or low wage-earning members, old people have become the main income earners (Van der Berg 1997: 4).

The important role played by social old age pensions in poverty alleviation is confirmed by Ardington and Lund's (1995: 557-577) survey in 1992 of 5 000 rural households in former KwaZulu. They found that pensions were very well targeted to poor households, to rural areas and to women. Pensions were the main source of income for 23% of the poor (the poorest two quintiles) and for 29% of the ultra poor (the poorest quintile). By contrast, they were the primary source of income for only 5% of the non-poor (Lund 1998: 7). The generous benefit levels also result in a substantial increase in income. On average income in pension-receiving households was nearly six-fold income without pensions (Lund 1998: 8-9).

Looking at the racial distribution of old age pensions among different categories of households, it can be seen that old age pensions are well targeted to reach the most vulnerable households. In black households, pensioners' incomes are particularly important because 60 per cent of urban and rural older black people live in multigenerational families compared to only 20 per cent of older whites. Thus, old age pensions have a redistributive role to play. Lund (1998: 4), analysing the distribution of old age pensions according to race, found that, in 1993, the bulk of old age pensions, 89 per cent, were claimed by black households with the result that

nearly a quarter of black households received an old age pension. Coloured and Indian households received disproportionately large numbers of old age pensions (8 and 2 per cent of the total), while most white households were eliminated by the means test. Only 38.4 per cent of elderly whites earned less than the R900 pension cut-off level (in 1996), while almost 30 per cent of elderly whites earned more than R2 000 per pensioner per month (Van der Berg 1997: 13).

Lund also found that although take-up rates were higher for men than for women, social pensions reached three times as many women as men. Indeed, seven out of every ten old-age pensioners are women, reflecting their “ lower eligibility age, higher average longevity and greater poverty” (Streek 1999: 31).

Two thirds of the total number of households receiving an old age pension are in rural areas. This translates into a satisfactory take-up rate for rural areas, given the difficulties of penetrating these infrastructure-poor areas. It also implies an important poverty-alleviation effect as the mean household size of 7.2 in black rural areas means that there, where poverty is most severe, many people live in households that are being reached by pensions. In fact, in rural areas, households with pensioners have higher average incomes than other households and old age pensions are the principal source of cash income for many (Van der Berg 1997: 10, after Donaldson 1993: 285).

There are a number of factors that influence the take-up rate of old age pensions.

- The means test - Most non-recipients of pensions are excluded through eligibility criteria, i.e. the means test.

- Administrative considerations – The administrative complexities of the means test (discussed earlier) are an important obstacle to increased take-up rates.
- Theft and corruption - Widespread corruption may create the illusion of a high take-up rate. There have been numerous reports of people faking identity documents to obtain pensions, recipients claiming two pensions and even cases where pensions were paid out to deceased people – the so-called "ghost pensioners". Many pension payments have been in arrears, there has been mismanagement of funds and there are also accounts of pensioners having their pensions stolen from them. In other words, ineligible individuals have been claiming pensions, while eligible individuals have not been receiving the pensions they deserve.
- Stigma - Personal aversion to taking-up benefits because of the perceived stigma that might accompany receiving benefits does not seem to be an important factor influencing the take-up of benefits (Van der Berg 1997: 10). According to McKendrick and Dudas (cited in Van der Merwe 1996: 400), only 10 per cent of elderly South Africans are financially independent, families are generally too poor to support those who are not and less than a quarter of non-white elderly people have per capita incomes exceeding the exclusion level. Thus, it is the norm to draw a state pension.

Coverage by old age pensions continues to grow. This growth is not so rapid as to be a cause for fiscal concern, but in some cases, it has exceeded budgetary provisions. This has been part of the cause of some localised fiscal crises, for example in the Eastern Cape (See Chapter 7).

5. Articulation with Other Programmes

As has been seen in preceding chapters, South Africa has a very large private retirement industry and an occupational pension scheme that covers more than 70 per cent of the formally employed.

However, although the high proportion of the formally employed covered by private and occupational pensions helps to reduce the costs of providing social old age pensions, it is not always so that those who contribute to occupational pensions will not need social pensions. Many South Africans earn such low incomes and/or work so irregularly that, even if they contribute to funds their whole working lives, their accumulated occupational or private pension is hardly any higher than if they had merely relied on the social old age pension. Another contributing factor may be the adverse incentives to reduce labour supply or earn less income that are created by the marginal rate of taxation (see Chapter 3). Also, most private retirement funds were only established after 1970 so that current pensioners have not necessarily been contributing long enough to earn adequate pensions. In addition, when racial parity of pensions was achieved in the early 1990's, white people found their pensions substantially reduced in real terms. Thus, people who had not made private provision, thinking that the state pension would be sufficient for their desired standard of living in retirement, found themselves with a much reduced pension.

The Smith Committee (1995: 18) found that 40 per cent of occupational pensions paid in 1995 had a lower value than the old age pension. Moreover, in 1993, just under half of all older people received occupational pensions, while 80 per cent received old age pensions. This means that about 30 per cent of occupational pension recipients were

also reliant on social old age pensions. In fact, the Smith Committee states that "the considerable gains made in the personal provision sector are not really making a contribution to reducing the costs of old age assistance" (Smith Committee 1995: 13).

The very large private retirement industry (already considered in chapter 3) is used mainly by upper income earners to supplement occupational pensions. It is also the only option for the 31 per cent of the labour force that is employed, but not covered by occupational retirement insurance. The current tax system is structured so that earners, particularly upper income earners, have significant incentives to provide for retirement. The contributions to pension funds are made from pre-tax income, the returns on investment in retirement funds are exempt from tax and lump sum benefits are taxed at average rather than marginal rates and then only after a considerable tax-free limit has been exceeded (Smith Committee 1995: 51). The latter is of concern because it encourages beneficiaries to take the maximum tax-free lump sum, rather than the maximum pension. This carries the risk that the pension may not be sufficient for their needs and that they will still need to rely on the social old age pension. Unfortunately these tax incentives, specifically the tax-free contributions, are ineffective in extending private retirement services to lower earners because they pay little, if any, income tax. Tax incentives are also regressive and it is clear that those who have the higher incomes tend to benefit most.

The relatively limited coverage of the population by occupational and private retirement insurance reveals the need for social old age pensions. This need is especially evident among the hundreds of thousands of people who have not been in formal employment, or have worked in a sector that is not covered by occupational

retirement agreements, or receive a pension that is too low to sustain them through their retirement years. It is here that the social old age pension plays a most important role.

6. The Role of Pensions in Economic Activity

The economic role of pensions is far more complex than simply income to be used for consumption purposes. As will be seen, they are a source of capital that is often used to stimulate small-scale enterprise, especially in rural areas. Also, they are a source of cash income that generates a demand for goods and services that can be bought rather than traded or self-produced. This stimulates local economic activity, especially in rural and deep rural areas. These ventures generate employment and, then, the economic activities of others through the multiplier effect. The flurry of economic activity at pension pay-out points bears testimony to this (Davidson and Stacey 1998: 245-250). In this sense, both from the supply and the demand side, pensions are not merely a hand-out but a stimulant to investment.

There are many diverse ways in which pensions can be used: Pensions can be used as capital for farming or small business activity. This is particularly important with respect to agricultural activity where agricultural extension loans are not available to all and food security is important. Because pensions are a regular and reliable source of income, they enable people to secure credit, whether for consumables or for inputs into agricultural production, at local markets. The pensions' predictability also facilitates the income-smoothing that is vital to the security of vulnerable households. Another important aspect to the economic role of the old age pension, as pointed out by Lund (1998: 7), is that although pensions are applied for by individuals, they are

largely pooled as household income. Thus, they can stimulate economic activity by any household member. Moreover, pension income has particular implications for rural women as it is more secure than the subsistence agriculture on which many survive.

It is worth noting that the provision of old age pension can have an undesirable impact on economic behaviour, especially if adverse incentives are created. Because income in multigenerational households tends to be pooled, the receipt of pensions by the older generation can influence the work-seeking activity of other household members. However, it is not easy to estimate how many people may have refrained from actively seeking work or creating their own work because of reliance on old age pensions.

7. Conclusion

Despite the many problems associated with the provision of the social old age pension, it is still an extremely effective instrument in alleviating poverty among the poorest households in South African society. Indeed, the Smith Committee approved of the current structure and recommended that the old age pension system "should be the centrepiece on which other pension systems must be built" (Smith Committee 1995: 5).

There is also no doubt that the need for the social old age pension will continue for many years to come. Widespread un- and underemployment in the economy mean that many people will remain unable to contribute to occupational or private pension funds. Those who do have occupational or private pensions tend to have contributed

to them irregularly or for a relatively short period so that the accumulated value of the private pension is not large. Nevertheless, despite the current fiscal sustainability of the old age pension programme, attempts should still be made to reduce the fiscal burden by increasing coverage for informal and low-income earners. Future costs will only be contained if the benefit is kept at sustainable levels, administration is improved and all those who can afford to contribute to their pension do so.

CHAPTER 9

SOCIAL ASSISTANCE FOR THE DISABLED

1. Introduction

According to the October Household Survey of 1996, disability prevalence in South Africa is around 5 per cent²³ (Department of Health 1997: 38). Blind people account for about half of this total. Disability prevalence, and especially blindness, is systematically higher among black people than among other race groups with the exception of physical handicap which is disproportionately evident in coloured and Indian men. Data also reveals that the extent of disability is highest in urban areas (Statistics South Africa 2000: section 9).

The link between disability and unemployment and, consequently, poverty is clearly evident in the frequency distribution of income of the disabled. In 1996²⁴, disabled people earned a mean income of R57 per month compared to the R515 earned by the non-disabled. This large differential can be ascribed, firstly, to the fact that a much

²³ This figure probably overestimates disability prevalence because it is derived from a survey of respondents' *perceptions* of their health rather than any objective measure of disability, such as that employed by medical practitioners to determine eligibility for disability grants.

²⁴ The figures that follow are 1996 estimates based on 1993 figures gathered in the Project for Statistics on Living Standards and Development (PSLSD) survey (also referred to as the SALDRU survey). It is important to note that because of the interpretation of survey questions, these figures severely undercount the number of the disabled. Thus, the population covered in this sample is only about one-fifth of those who receive disability pensions, and probably the most severely disabled who presumably have lower incomes than the others who qualify for disability grants (Van der Berg 1996: 14).

higher percentage of the disabled, 92 per cent, than the non-disabled received no private income whatsoever (Van der Berg 1996: 15). Secondly, of those disabled people with a private income, none earned above R2 000 per month. Certain disabilities prevent people from finding employment or, at least, place them in a first-out position in the labour market. This applies particularly to low-skilled workers, occupations where labour supply is high and work that relies heavily on physical labour. The situation is aggravated by the slowness with which the private sector has responded to legislation demanding that work-places are made more easily accessible to the disabled. Moreover, disabled people generally require a higher disposable income to cover the medical costs associated with disability. Thus, households with disabled members, and in particular disabled household heads, are systematically more likely to be poor.

Recognising the barrier that disability poses to the search for well-remunerated employment and the high costs of treatment for disability, the South African social security system provides social protection to the disabled. This is done using a variety of measures and transfers, but the exact type of assistance depends on the origin and nature of the impairment. Social insurance benefits in the form of unemployment benefits during illness and compensation for occupational injury and disease have already been examined in Chapters 4 and 5, together with compensation for road accident victims in Chapter 6. This chapter looks at social assistance benefits for disability, namely disability grants, care-dependency grants, grants-in-aid and social relief for distress. These benefits provide financial support to those who are rendered disabled by incidents that are not work-related or who, although injured at work, are

employed in activities that are not covered by the Compensation for Occupational Injuries and Diseases Act (COIDA) and the Unemployment Insurance Fund (UIF).

2. The Disability Grant

The disability grant is the most important transfer used to ease the challenge facing disabled people. There are two dimensions to this challenge. In the first place, there is the need for medical attention and to cover the costs thereof, and, secondly, there is the loss in earning power associated with disability that reduces the disabled person's capacity to sustain his/her family (Van der Berg 1994: 6). Approximately 500 000 people (Van der Berg 1999c: 492) receive disability grants, making this category of benefits the second largest transfer item, after social old age pensions. The cost to the state was R4.4 billion in the 1998/99 financial year, equivalent to 26 per cent of total social assistance expenditure (Van der Berg 1999b: 19).

All severely physically and mentally disabled persons, eighteen years or older, may receive a disability grant. The value of the grant is currently equal to R540 per month and the recipient is also entitled to state medical care, both subject to a means test. The disability grant may not be held in conjunction with any other social grant, other than the grant-in-aid benefit, and when the recipient reaches retirement age the disability grant is converted into a social old age pension.

In practice, a clear distinction is not usually made between permanent or long-term disability grants and temporary or short-term disability grants. Often recipients of temporary disability grants simply continue to draw these benefits so that the grant becomes *de facto* a long-term disability grant (Community Agency for Social Enquiry

1998: 33). Consequently, it may be an idea to replace the temporary disability grant with social relief, which is provided for a finite period with a definite end. These short-term payments are already available to those who are awaiting permanent assistance and those who have been found medically unfit to work for a period of less than six months. If such an expansion of the social relief programme is to occur, the administration of social relief would have to be improved as it is currently applied very haphazardly across provinces (Community Agency for Social Enquiry 1998: 33).

The disability grant is not a statutory right, but rather a discretionary award (Lund 1994: 7) made on the basis of certain medical eligibility criteria and a means test. The former determines whether an individual is eligible for a grant while the latter determines the exact value of the grant.

2.1 The Medical Eligibility Criterion

The medical eligibility criterion requires that the disability be assessed as permanent and severe enough to prevent the person from engaging in remunerative employment. A disability is considered “severe” if it can be assessed as at least 50 per cent incapacity. The requirement that the “disability makes him or her incapable of entering the labour market” (Republic of South Africa 1998c: 6, section 3b) establishes a clear link between disability and the individual's labour market status. Thus, the grant can be seen as compensation for loss of earnings.

As with the medical tests for COIDA purposes, the decision whether to award a disability grant in a particular case is complicated by the fact that the assessment of disability is an arbitrary one. Although special charts exist according to which the

severity of the disability can be assessed, doctors' opinions of what constitutes a 50 per cent disability may differ. There is a lack of uniformity in assessing eligibility and degree of disability. Although it is possible to appeal against the outcome of a medical test, the final decision remains a somewhat discretionary one.

The assessment of disability has often been criticised because it only takes into account the extent of physical impairment and not how the disability affects the person's ability to find work. In South Africa's high unemployment economy even the slightest disability can render a person *de facto* unemployable or place currently employed individuals in a "first-out" position. Yet, the disability may not be severe enough for a disability grant - a situation that is aggravated by the absence of an unemployment benefit.

Another criticism of the medical eligibility criterion is that it only considers whether the disabled person is capable of performing work in general, not necessarily the work for which he was trained. Indeed, the law states that a condition of the grant is that "he or she does not refuse to accept employment which is within his or her capabilities and from which he or she can generate income to provide fully or partially for his or her maintenance" (Republic of South Africa 1998c: 6, section 3b). Thus, if an injury prevents someone from performing the job for which he is trained, rendering him employable only in a (less skilled) position that may be remunerated at a far lower income, he does not qualify for a disability grant. This is because the disability grant is not an instrument of income maintenance. It compensates for a loss of earnings, but only by providing a minimum income.

A final point is that, in situations of very deep poverty, grants for (temporary) disability may create disincentives for people ever to get well. The most prominent example is of tuberculosis sufferers who purposely do not take their medication so that they can continue to access the grant (Dick 1995: 549-550).

2.2 The Means Test

The means test for disability grants operates in a similar manner to that for old age pensions. After medical eligibility has been established, the exact size of the grant is determined by a means test that operates according to a sliding scale. The maximum benefit is currently set at R540 and reduced by R1 for each R2 increase in income above the threshold income (30 per cent of the maximum grant). This effectively imposes a marginal income tax of 50 per cent on additional income earned above the threshold level. Consequently, the means test has been criticised for “penalis(ing) and demotivat(ing)” disabled people who have private savings or who take up (usually lower paid and often temporary) work (Department of Welfare 1996: 76). Moreover, employed disabled people forfeit state medical benefits if they earn more than R1 700 per month (Department of Welfare 1996: 76).

The means test once again gives rise to a poverty trap situation. The 50 per cent marginal income tax means that there is little incentive for a disabled person to take on work if it is offered to him. This is a particular problem because the work offered tends to be temporary and low-paid (Lund 1998: 12), rendering the income differential between wage and disability grant rather small. Moreover, the many obstacles that a disabled person may face if the hiring firm is not well adapted to accommodate his particular disability may prove too overwhelming. In addition,

temporary work is undesirable because of the difficulties and delays in reinstating the disability grant once the contract expires. The loss of state medical benefits at the R1 700 income mark also creates a disincentive for people in that income bracket to earn higher income, especially given the escalating costs of medical care. This effect could be lessened if state medical benefits were reduced proportionately as income rises (i.e. according to a sliding scale), rather than forfeited all at once.

3. Coverage

In 1998, 620 670 people received disability grants every month (Department of Finance 1998a: 34). This is equivalent to about one third of all disabled people in South Africa. Most of those 66.6 per cent who were not in receipt of disability grants were either older than 65 years (or 60 years in the case of women) or younger than eighteen. They did not receive disability grants because they did not qualify in terms of the age criterion. Rather, elderly disabled people and the disabled youth received old age pensions and care dependency grants, respectively. The number of beneficiaries in 1998 was 17.8 per cent fewer than in the previous year following the extensive re-registration process to eliminate ineligible beneficiaries (Department of Finance 1998a: 34).

The racial distribution of disability grants exhibits a different pattern to that of old age pensions. Among whites the number of disability grants per 1000 of the population is 8, among blacks 12, among Indians 23 and among coloureds 31 (Van der Berg 1999b: 20). This distribution is not completely explained by disability prevalence across different race groups. Disability prevalence is in fact lowest among coloureds at 4.5

per cent and highest among blacks at 6.1 per cent (Community Agency for Social Enquiry 1999: 17).

The differential may arise from the application of the means test that results in disability grants being received more frequently by those with lower incomes. Indeed, although 19 per cent of white disabled people were employed full time in 1998, only 9 per cent of Indian, 6 per cent of black and 4 per cent of coloured disabled people were employed full time (Community Agency for Social Enquiry 1999: 30). Consequently, it is reasonable to expect that a higher percentage of coloured people would qualify for disability grants in terms of the means test. But the means test does not explain the low coverage among black people. They have the highest disability prevalence of 6.1 per cent and a very low full-time employment rate of 6 per cent for disabled people. In addition, the increased exposure of black people to violence and their over-representation in hazardous kinds of work suggests that this is a serious mistargeting. The low take-up rate of disability grants among black people could be because of a lack of awareness, lower literacy rates, the high percentage of rural residents, less geographic mobility, intimidation by welfare authorities or discrimination in the discretionary allocation of grants. There may also be other factors at play. In Van der Berg's (1999c: 494) opinion, the very high coloured and Indian figures may reflect abuse of the system that may have arisen under the apartheid dispensation when the different administrations applied eligibility rules differently.

Take-up varies significantly across provinces. The Community Agency for Social Enquiry (1999: 33) found that the number of disabled people receiving disability grants ranged from a high 71 per cent in KwaZulu-Natal to a low 33 per cent in

Mpumalanga. Studies show that take-up rates among rural people are especially low. This may be because their limited access to doctors makes it difficult for them to undergo medical assessments (Ally 1998: 4).

Women are under-represented in the disability grant receiving population. They receive only 46 per cent of all grants despite exhibiting higher disability prevalence than men (Lund 1998: 6). The under-representation appears even more severe when one considers that women's income tends to be between 60 and 89 per cent of men's (Budlender 1998) and they are, thus, less likely to be working in sectors covered by workmen's compensation and, if single, are less likely to be excluded from receiving disability grants in terms of the means test.

4. The Role of the Disability Grant in Poverty Alleviation

Although disability grants are claimed by individuals, they are an important source of income for entire households, especially for the three-generational household that is common in South Africa. Although the disability grant is set at the same level as the old age pension, the poverty alleviating effect of disability grants can not be as widespread because the number of beneficiaries of disability grants is a third that of old age pensions (Department of Finance 1998a: 34). Also, the magnitude of the disability grant's effect on poverty alleviation within households is not the same. While the old age pension provides an income to a person in the economically inactive phase of the life-cycle, the disability grant is awarded to a person who is in the most productive phase of the life-cycle – someone who could potentially be earning much more. Thus, the disability grant replaces a wage or a breadwinner's income.

Nevertheless, as noted in the previous chapter, average wages and individual incomes in many regions and sectors of South Africa are at such a level that the disability grant is not much less than what would often be received from a (informal) source of employment. Thus, because poverty levels are so high, those households who are in fact in receipt of a disability grant find that it has a significant impact on poverty alleviation. Old age pensions and disability grants combined contribute approximately 20 per cent of the income of the second through fifth deciles in rural KwaZulu-Natal (Lund 1994: 10). In fact, many households in the lower income deciles are poor precisely because they do not have an elderly or disabled person who can access social security benefits (Lund 1994: 10). Disability grants form a particularly important share of the income of households living in rural households, but less so in deep rural areas. This suggests, once again, that the take-up of disability grants in deep rural areas is not as high as it should be.

5. Articulation with Other Programmes

The disability grant cannot be examined in isolation. Consideration needs to be given to the articulation between the disability grant and other areas of social policy, such as:

- Old Age Pension: It has already been noted that on turning 60 (or 65 in the case of men), the disability grant is converted into an old age pension. The higher take-up rate of the old age pension shows that retired disabled people have better access to social grants than their younger counterparts. About 78 per cent of disabled people who are eligible by age for the old age pension receive them (Community Agency for Social Enquiry 1999: 33). This take-up rate is approximately the same as the

take-up rate of old age pensions among the elderly non-disabled (see Chapter 8). This suggests that lack of awareness of disability grants may be a very significant factor in determining take-up.

- Social security for unemployment: The inadequacy of the unemployment insurance system may induce the abuse of disability grants. Many employers, knowing that retrenched employees will not be able to fall back on adequate unemployment compensation, may recommend dismissed employees for disability grants or help them qualify for workmen's compensation. The Department of Welfare confirms this (Ally 1998: 4). For this reason it is important that the 50 per cent disability criterion is stringently applied. Alternatively, consideration needs to be given to providing some form of social assistance to the unemployed to reduce this incentive.
- Workman's compensation: As was seen in Chapter 5, not all sectors and occupations are covered by the Compensation for Occupational Injury and Diseases Act (COIDA). This means that the disability grant is the only source of compensation for people in these sectors who are injured at work. Extending coverage by COIDA may help to reduce pressure on disability grants. It would also provide some protection to those workers who are not injured severely enough to qualify them for the disability grant. The minimum percentage disability required to qualify for a benefit is lower for workman's compensation than for the disability grant. Consequently, there are many disabled people active in sectors not covered by COIDA who do not qualify for a disability grant, but would have received compensation under COIDA had their sector been covered. As the system is structured at the moment a number of people injured at the workplace do not receive compensation from COIDA nor disability grants.

- Health care policy: Currently, recipients of disability grants are entitled to free health care at public hospitals and clinics. The Community Agency for Social Enquiry (1998: 3) recommends that in cases where recipients have their own private medical aid, free health care provision should be stopped. Such a move will not generate very large savings, though, as figures in the October Household Survey indicate that only about 15 per cent of disabled people have medical aid cover (Statistics South Africa 2000a: section 9).
- Child support grants: Another recommendation is that disabled parents should be permitted to access child support grants for a longer period than non-disabled parents. The reason provided is that it is more difficult for someone dependent on a disability grant, a small amount of R540, to afford to care adequately for a child (Community Agency for Social Enquiry 1998: 33).
- Road Accident Fund: In cases where disability arises from a road accident, victims are eligible for a monthly benefit from the Road Accident Fund. Depending on the magnitude of the benefit, the victim may still have a sufficiently low income to qualify for a disability grant. In general, the lower a victim's pre-accident income and the greater his degree of fault in causing the accident, the lower will be the monthly benefit and the more likely it is that he will qualify for a disability grant, too. The articulation between the monthly benefit and the disability grant was examined more closely in Chapter 6 on the Road Accident Fund.

Not only must the linkages between different programmes be considered, but also the linkages between the responsibilities of different departments. The Department of Welfare has contended for some time that issues that were traditionally thought of as

falling within the ambit of Welfare are in fact intersectoral responsibilities. Attempts are, thus, being made to convince other departments to bear certain costs associated with disability. For example, it has been recommended that the Department of Welfare be responsible for the cost of disability grants and full-time care while the Department of Health bears medical costs (Community Agency for Social Enquiry 1998: 35). Similarly the Department of Education could subsidise the costs of special schools for disabled children and the Department of Transport could cover special transport needs. Thus, costs could be spread over different departments and it is reasonable to expect that this could result in improved all-round efficiency as each department concentrates on its own area of expertise. The provision of these facilities does not justify a reduction in the level of the disability grant, though, as some important needs would fall outside the programmes covered by subsidies.

Finally, as occupational disability insurance only covers injuries at the workplace, there is a gap in coverage which neither occupational disability insurance nor disability grants fill. There are many people who, as Lund (1998:12) puts it, “fall through the cracks between private and public provision”. A typical case is the person who is injured outside of the workplace in such a way that his disablement is not severe enough to qualify him for a permanent disability grant, but severe enough for him to be dismissed from work. Thus, he finds himself disabled and unemployed without a disability grant and limited unemployment compensation. Moreover, as he was not injured at the workplace, he receives nothing from the Compensation Fund. For higher income earners, private disability insurance could fill this gap, but the lower income earner has little support. The situation is even worse for the person with less than 50 per cent disability, but whose disability constitutes a barrier to

employment. Here, it is important that compliance with the Employment Equity Act is carefully monitored so that employers take “measures to identify and eliminate employment barriers” and “make reasonable accommodation” for disabled people (Republic of South Africa 1998a: Chapter 3, section 15).

6. Other Grants for Disability

In addition to the disability grant, there is assistance provided to specific categories of disabled people through care-dependency grants, grants-in-aid and social relief.

6.1 Care Dependency Grants

Grants of up to R540 per month can be paid to the care-giver(s) of children with severe mental or physical disabilities who require permanent home care. They are available to the carers of disabled children younger than 18 years, unless the child is still in secondary school, in which case the upper age limit can be extended to 21. As with the disability grant, the care dependency grant is subject to a medical eligibility criterion and a means test. The medical assessment must confirm that the child’s mental or physical impairment is such that he requires full time care. The means test requires that the family’s combined income does not exceed R48 000 (Community Agency for Social Enquiry 1998: 34).

The objective of the care dependency grant is to cover the costs incurred by the family of a disabled child who is cared for at home, i.e. costs of shelter, care by a personal assistant and extra costs such as special transport, special diet and special schooling. In this way, the grant can be seen as an attempt by the state to encourage home care

rather than institutional care of disabled children, especially in the light of the reduction in subsidies to institutions offering special care. In addition, the care dependency grant is not only intended to cover the direct costs of medical treatment and general care, but also to compensate for the effect that the presence of a disabled child has on family income-generating activity. Taking care of a disabled child can reduce economic productivity, thus limiting the family's ability to generate income.

Providing care dependency grants, and grants-in-aid, is certainly cheaper for the state than having the child cared for in hospital or an institution. However, cost considerations alone do not justify the replacement of institutional care by care dependency grants as significant numbers of people are so severely disabled that it is virtually impossible for them to be cared for at home, especially given the socio-economic position of many South African households.

In mid-2000, about 22 000 care dependency grants were being paid every month (Ramklass 2000: 7). Take-up rates vary from just over 7 per cent in Mpumalanga to 22 per cent in KwaZulu-Natal, averaging slightly over 14 per cent for the country as a whole (Barberton 2000: 13-14). This amounts to a cost of R12 million per month or R146 million per annum (Barberton 2000: 16).

Many children have been excluded from the care dependency grant, specifically deaf and blind children. This is because they have been evaluated as not needing full-time care. Nevertheless, their need for attention may be so high that their parents are often unable to work. At the least, they may need part-time care. The Community Agency for Social Enquiry (1998: 36) recommends that the Department of Welfare should

look into the possibility of partial grants in these cases. The extension of the care dependency grant to children suffering from chronic illness and more moderate disabilities has also been considered. The fiscal implications are substantial. If 100 per cent take-up was achieved for children with chronic illness, moderate and severe disability, state expenditure on care dependency grants would reach over R3 billion (Barberson 2000: 17-18).

In the future, there is going to be increased pressure on the care dependency grant as the number of HIV positive children increases. There are already some children with AIDS receiving the grant and it has been recommended that care dependency grant be extended to all children who develop HIV/AIDS (see, for example, Ramklass 2000). Estimating that the number of HIV positive children under the age of eighteen will stabilise at around 424 000, Barberson (2000: 18-19) calculates that the extension of coverage to HIV positive children (together with the inclusion of moderately disabled children) will push expenditure on care dependency grants up to R7.4 billion per annum, if 100 per cent take-up is achieved.

Even assuming more moderate take-up rates, these proposals, if accepted, could increase expenditure on care dependency grants tenfold. Working with more realistic take-up rates of 30 per cent take-up among HIV positive children, the current 14 per cent take-up among severely disabled children and assuming 5 per cent take-up among the moderately disabled and 15 per cent among chronically ill children, the care dependency grant would still cost R1.2 billion. This represents an enormous increase on the current annual expenditure of R146 million and financing these extensions will put provincial welfare budgets under severe strain. Although socially

desirable, it is unclear how feasible these proposals are, given current budgetary constraints.

6.2 Grants-in-Aid

The grant-in aid is available to severely physically or mentally disabled adults who require full time or part-time assistance with everyday activities. It is paid over and above whatever grant or pension, such as a disability grant or an old age pension, is already being received. In 1999, the grant-in-aid benefit was equivalent to R94 per month for full-time care.

Similar problems to those associated with the disability and care dependency grants are found with the grants-in-aid. Like the care dependency grants, grants-in-aid have been poorly accessed in the past. In 1998, 8 719 benefits were paid every month (Ally 1998: 6), but it is estimated that many more people than this were being cared for full-time by family members and the community. The low take-up rate is predominantly due to the now familiar range of obstacles, such as a lack of awareness, low functional literacy and a lack of easily accessible welfare offices. Others are excluded by the means test.

7. Conclusion

Social assistance for disability is the only major set of social assistance programmes that is not aimed at a particular phase in the life-cycle and that can be received during the economically active years. The use of the medical assessment as eligibility criterion introduces some subjectivity into the award of benefits. Coverage is not as

high as it should be and is racially and geographically skewed with groups with a lower prevalence of disability exhibiting higher take-up rates. The disability grant is also the social assistance programme that has the greatest articulation with other social assistance and insurance schemes. HIV/AIDS is perhaps the most important challenge facing social assistance for disability and in the next ten years, there is likely to be a large expansion of its benefit programmes and accompanying fiscal strain.

CHAPTER 10

SOCIAL ASSISTANCE FOR CHILDREN

1. Introduction

In South Africa, children are seriously at risk. The racial inequalities of apartheid have left most children with severely inadequate access to health care, education and nutrition. The results of this are clearly evident if one examines key socio-economic indicators. There is a very high incidence of stunting, 87 per cent of black children are considered nutritionally compromised (Lund Committee 1996: 3) and the under-5 mortality rate is 59.4 per 1 000 live births (Department of Health 1998: 6).

This is caused and compounded by the poor economic position that many parents find themselves in. Parents or care-givers of children are typically in young adulthood and, therefore, in the relatively low part of their lifetime's earnings trajectory (Barr 1998: 247). In South Africa many women fall pregnant for the first time while still in their teenage years, in other words at a time in the lifecycle when earnings are very low and unemployment is common. Approximately 35 per cent of children live in households headed by women, most of them single parents (Van der Berg 1999b: 19). They are employed mainly in the low-paying 'survivalist sector' (Lund Committee 1996: 3) and have poverty rates of 60 per cent - double the equivalent male poverty rate (Van der Berg 1999b: 19). The female share of total income earned in South Africa is only 30 per cent (Du Toit 1998: 50), while the unemployment rate is as high as 47 per cent for black women (Central Statistical Service 1996). As a result, 61 per cent of children under the age of 16 live in poverty (Biersteker and Robinson 1996: 8). Moreover, racial and regional distortions still persist in socio-economic conditions

and the distribution of quality social services, although attempts are being made to iron out these inequalities. The poorest families are black, especially those living in rural areas and in the Eastern and Northern Provinces.

Of particular concern is the impact of the HIV/AIDS epidemic on children. HIV/AIDS affects children in two ways. Firstly, they may contract the disease themselves, *in utero* or through breast-feeding. The 0-4 age category accounts for about 6 per cent of all new infections projected between 1995 and 2010 and it is predicted that by 2005, half a million children will be HIV positive (AIDS in South Africa 1999: 16). Ten years later, this figure is expected to rise to two children per household (Ramklass 2000: 2). Secondly, children's parents may succumb to the disease so that children become increasingly vulnerable to poverty, as their parents become less economically productive and less able to care for them, and are eventually orphaned. A 1998 survey puts the level of HIV infection among pregnant women at as high as 22.8 per cent (AIDS in South Africa 1999: 16). By 2005, this will probably be the level of infection of the total adult population in many provinces (Ramklass 2000: 3). Consequently, the number of AIDS orphans is expected to increase dramatically in coming years, to as many as 500 000 in KwaZulu-Natal alone by the year 2010 (Sunter and Whiteside 2000: 80).

Recognising the vulnerability of children and young families, the government has committed itself to protecting them. Article 28 of the Bill of Rights in the Constitution stresses that children have a particular right to have their basic needs met, emphasising basic socio-economic rights without any limitation (South Africa 1996: Article 28). Government's macroeconomic strategy, "Growth, Employment and

Redistribution” re-affirmed its socio-economic commitments to children, but its key objective of reducing the budget deficit may restrict its capacity to spend on policies affecting children (Department of Finance 1996). In 1996, the National Programme of Action for Children in South Africa was formed to prioritise children’s needs in the allocation of resources and there are a number of sectoral commitments to the specific needs of children within the various government departments (Biersteker and Robinson 1996: 13). Finally, the Convention on the Rights of the Child is a powerful monitoring body of the situation of children in South Africa and gives input into most policy changes. Internationally, South Africa has accepted the 1990 World Summit for Children’s goals and in 1995 ratified the United Nation’s Convention on the Rights of the Child.

Social transfers to children form an important part of government’s policy to improve the welfare of children. Certainly they demand a great share of fiscal resources, 11.2 per cent of social assistance expenditure or just under R2 billion in the 1998/99 fiscal year (Department of Finance 1998a: 29). South Africa is in a transitional phase with regard to child transfers. The state maintenance grant, which has been the backbone of child and family support in South Africa since 1960, is being phased out and is being replaced by the child support grant. The two systems have been running concurrently since 1997. In addition, there are other social transfers, such as the foster care grant and the care dependency grant available to children with specific needs, and also social services that are provided to children by various government departments. These are complemented by a system of private maintenance through the judiciary, customary law obligations for private maintenance and the informal networks of family and community.

This chapter will focus on social transfers to children, but also look at their articulation with the other sources of support mentioned above. Most attention will be devoted to an examination of the child support grant and how it improves (or not) on the old state maintenance grant with respect to particular design elements, fiscal sustainability and potential coverage.

2. The Old State Maintenance Grant

The state maintenance grant, until 1997, consisted of two separate allowances: a parent's allowance and a child allowance. The parent's allowance was set at a maximum of R430 per month and the child allowance at a maximum of R135 per child per month (Vorster and Rossouw 1997: 317). Both allowances were subject to a means test and a sliding scale that effectively imposed a 50 per cent marginal rate of taxation on income earned above a R90 income threshold up until the exclusion level. The allowances were payable until the child turned sixteen²⁵ and for a maximum of two children per family. Although in divorced or separated families either parent could receive the parent's allowance, most recipients were single mothers. Then, in 1997, the parent component of the state maintenance grant was eliminated and later the cut-off age for eligibility for the child component was reduced to six years.

Prior to 1997, when both the parent's allowance and the child allowance were being awarded, state maintenance grants were fairly generous – especially considering the low levels of household income in South Africa. For example, the maximum

²⁵ The Social Assistance Amendment Act of 1996 stated that if the child was still undergoing secondary or tertiary education the grants could be paid until the age of 18, and sometimes even older.

allowance for a single parent with one child amounted to a transfer of R6 444 per year, or R3 222 per capita. Although such a generous benefit was desirable in terms of its potential impact on poverty alleviation, such levels of expenditure were fiscally unsustainable. It was calculated that if all South Africans claimed the benefits for which they were eligible in 1997, it would have cost the state R5 billion rand or more per year - considerably more than the budgeted R1.2 billion (Vorster and Rossouw 1997: 316).

It is only because take-up rates were so low that the state was able to afford such a generous level of benefits. In the 1995/96 financial year, approximately 205 741 adults received state maintenance grants for their children (Van der Merwe 1996: 407), but this was merely a fraction of the 2.8 million women who qualified under then prevailing eligibility criteria (Department of Welfare 1996: 76). Also, although poverty is concentrated among black children, most recipients were coloureds, Indians and whites. Estimates from 1996 suggest that only 3 per 1 000 black children were receiving grants, compared to 50 per 1 000 coloured children, 45 per 1 000 Indian children and 14 per 1 000 white children (Vorster and Rossouw 1997: 330). The coloured population is particularly well covered and although this group constitutes less than one-tenth of the total population, they accounted for almost half of the beneficiaries. By comparison, take-up among the black population was particularly low, which is of particular concern given that poverty rates were much higher. Further evidence of racial distortions in the take-up of grants was that only 0.3 per cent of black extra-marital children enjoyed coverage (Van der Merwe 1996: 407). Thus, *de facto* racial discrimination persisted in the coverage of benefits. If all those who

qualified for maintenance grants had received them, five million children would have received benefits (Van der Merwe 1996: 407).

The low take-up was certainly largely due to inefficient administrative and information structures. This was aggravated by the fact that discrimination in the allocation of grants was only removed relatively recently and the awareness and capacity to claim grants still had to be created. Certainly, before the amalgamation of the multiple welfare departments, many homeland administrations did not administer the state maintenance grant at all, and many of those who did only awarded the child allowance and then, sometimes, for one child only. Some administrations, for example Bophuthatswana, refused to award grants if mothers had been divorced or deserted (Lund Committee 1996: 78).

Another reason why the state maintenance grant was ineffective in reaching the poor is that it was designed around a family form that does not fit the South African reality. The state maintenance grant assumed a two-generational nuclear family, with one male breadwinner and a mother who devoted her time to childcare and household activities – and, if she worked, it was assumed to be at a very low wage. The state maintenance grant was there to support the mother in the “unusual and uncommon” event of death or divorce (Lund Committee 1996: 78). Clearly this model is inappropriate. In the first place, it fails to consider the more fluid structure of most black families and, secondly, it does not cater to the increasing number of single parents and female-headed households. The latter is a phenomenon that has been observed the world over, but is particularly pronounced in South Africa due to the family fragmentation that was caused by apartheid’s migrant labour policy and

homeland system. Today, many South Africans live in three- or four-generational households, many of them headed by women who are usually lower income-earners. Typically, the middle generation is absent, earning an income away from home (Lund Committee 1996: 16-18). Dual households also often emerge when fathers remarry or take on additional wives or girlfriends. 35 per cent of women fall pregnant while still in their teenage years (Department of Health 1998: 26) and often continue to bear children well into their forties, resulting in larger families. Consequently, family boundaries are hard to define and it is, thus, very difficult to target benefits at children through their parents.

It is well established that the provision of benefits often induces people to change their behaviour in significant ways in order to qualify for grants. Sometimes these changes are desirable, and often the rationale for the provision of the benefit, but other times these changes have negative social and economic consequences. The state maintenance grant is no exception. Van der Berg (1996: 12) noted a number of perverse incentives that may arise in poorer communities as a result of the generosity of child support benefits:

- Benefits may alter household composition by creating an incentive for a single mother to weaken their relationship with the father. As a single income earner, she is more likely to satisfy the eligibility requirement of the means test.
- The means test creates a poverty trap situation that may discourage mothers from seeking (remunerated) employment. Especially in rural areas, low average wages may render the receipt of grants a more attractive source of income than employment.

- The incentive to reduce fertility rates is reduced. Children can become an important source of income. And, of course, greater fertility places even more pressure on future fiscal and social security resources. With respect to the state maintenance grant, however, this incentive was much reduced as benefits were restricted to a maximum of two children per family.

In the early to mid-1990's it started to become increasingly evident that the state maintenance grant was no longer an appropriate transfer with which to target children living in poverty. The benefit level was fiscally unsustainable, but yet take-up was too low, the benefit was complex to administer efficiently, designed around an inappropriate family structure and created a number of perverse incentives. Because of these concerns, the Lund Committee on Child and Family Support was appointed in 1996 to explore policy options to effectively target programmes for children and families. Their recommendations led to the legislation of a new child support grant in April 1998.

3. The Child Support Grant

The child support grant of R100 is payable to the primary care-giver of children. Unlike the state maintenance grant that was limited to a maximum of two children, the child support grant is paid to every child who is eligible in terms of the means test. The cut-off age for receipt of a grant has been drastically reduced from sixteen years to six years. Although means-tested, the child support grant is not subject to a sliding scale. It is a flat rate benefit and, provided that the household income is below R900 per month, the entire R100 is paid (Germiston Welfare Office 1999).

Despite the fact that benefits are much lower and are received for a shorter period, in many respects, the child support grant represents a substantial improvement on the state maintenance grant. Although individual families, especially smaller families with older children, may be relatively worse off, on the whole the child support grant should lead to substantial gains for many families and certainly for the social security system as a whole. Five areas are of particular importance.

3.1 Appropriateness to Family Structure

As opposed to the two-generational nuclear family unit around which the state maintenance grant was built, the child support grant takes cognisance of the fluid structure and extended family networks that are typical of most South African households.

The key principle underlying the grant is that of “following the child” and, consequently, the grant is paid to the primary care-giver. This person can be a grandmother, aunt or close family friend, for example, which means that the grant is especially suited to those families where the biological parent is not always present. Thus, the reach of the child support grant is much “wider” than it appears at first glance. But, while eliminating some problems, payment to the care-giver raises other problems. For example, a child may have more than one primary care-giver over a period of time and because it is more difficult to identify the primary care-giver than the mother, conflict may arise as to who exactly the primary care-giver is.

Another improvement is that there is no longer a limit on the number of children in a particular family who may receive a grant. This means that the child support grant

will not be forfeited simply because children are members of large families. This is particularly important because it is in the largest families that the incidence of poverty is greatest.

These two elements extend coverage to all poor children, regardless of their particular family structure.

3.2 The Trade-off between Benefit Level and Age of Exclusion

Targeting the child support grant at the very poor was essential given the constrained fiscal environment. In setting benefit levels and eligibility criteria, the government had to find a satisfactory position between two extremes. The one extreme was to provide a generous benefit to a narrow band of people by setting the exclusion age at a very low level and tightening the means test (a so-called “deep and narrow” benefit). The other was to include older children and relax the means test, but substantially lower the benefit level (a so-called “shallow and wide” benefit). The South African position can be seen as a combination “shallow and narrow” one (Lund Committee 1996). “Shallow” because of the low benefit and “narrow” because the means test is fairly severe and the age of exclusion is low.

Although it would be desirable to reach as many children as possible, cost-containment required that a limit be set and the Lund Committee found that the current benefit level and eligibility criteria better target the most vulnerable.

- Intervention during the first six years can have the most significant impact on the child’s health, nutrition and nurturing.

- It also marks the end of the pre-school years for most children, after which they may be able to be reached by interventions that operate through the school system.
- The means test together with a lower benefit level means that the grant will be of relatively more assistance to the ultra-poor.

Thus, the child support grant focuses on reaching all poor children in the most vulnerable phase of their lives. Although it is much “narrower” in definition, in practise it will reach a much “wider” spectrum of people than the old maintenance grant did.

3.3 Fiscal Sustainability

The child support grant is designed to be fiscally sustainable even when maximum take-up is achieved. The benefit level has been reduced to a flat R100, the means test’s exclusion level is lower and the eligibility age of the child has been reduced from sixteen to six years. At first glance, its introduction appears to be a cost-saving measure and indeed, the high cost relative to return (in terms of coverage and poverty relief) seems to have been a main reason for the abolition of the state maintenance grant. If 100 per cent take-up is achieved over the next five years, the child support grant programme will still cost between R2.1 billion and R3.6 billion less than the state maintenance grant at full take-up would have (Haarman and Haarman, cited in Vorster and Rossouw 1997: 332). However, precisely because take-up rates of the child support grant are expected to be higher, the new system will cost the state more than the state maintenance grant did.

In the 1998/99 financial year, social assistance for child and family care amounted to R1.9 billion or 11.2 per cent of the social assistance budget (Department of Finance

1998a: 29). As a percentage of social assistance expenditure, this item has remained more or less the same size since 1995/95 (Department of Finance 1998a: 29). This indicates that despite pessimistic statistics of take-up rates, increased take-up must have been at least enough to offset the reduced expenditure caused by the phasing-out of the state maintenance grants. It is also significant that while government provision of welfare services in general, especially institutional care, has declined substantially in the last year, expenditure on social welfare services provided to children has increased by 14.2 per cent (Department of Finance 1998a: 29). Expenditure on social welfare services is an important complement to social transfers and underlines government's commitment to child and family care.

3.4 Administrative Considerations

One of the advantages of the child support grant is that it will be much easier to administer than the state maintenance grant. This is chiefly because of the abolition of the sliding scale for the means test. Provided that the age eligibility criterion is fulfilled and income is below the exclusion threshold the complete R100 grant is paid. This eliminates the marginal rate of taxation of the sliding scale. It does not remove the poverty trap, however. Those earning at the margin now stand to lose the entire grant if their income rises just above the exclusion level rather than only a portion of the benefit as would be the case with a sliding scale. For a while, the Lund Committee considered using a measure of nutritional status in the means test, but this was eventually decided against because the child support grant should help prevent poverty and malnutrition, and not be conditional on the visible effects of extreme poverty.

Despite the administratively simple means test, there are, nevertheless, some serious administrative obstacles that need to be overcome:

- The child support grant is paid on a quarterly basis. Many argue that this will prove an obstacle to extending coverage because bank facilities are scarce in rural, and even many urban areas, and many people are unfamiliar with them. In addition, there are the problems of functional illiteracy, long travelling distances and bank transaction costs. It is also argued that the three-monthly payment cycle may prove difficult for poorer households who tend to live from day to day (Vorster and Rossouw 1997: 322). These are not obstacles that cannot be overcome, though. Despite similar problems, the old age pension manages to achieve take-up rates of 80 percent. The Department of Welfare could investigate the use of mobile units and private contractors to extend coverage. The use of banks and post offices means that recipients are able to access their money in amounts and at times that are convenient to them, rather than having to appear on a specific day. Larger quarterly bank payments also reduce the administrative costs per transfer and minimise the risk of cash theft.
- The amount of documentation required for an application for a child support grant is immense. It is more than what was required for the state maintenance grant. The applicant has to furnish the child's identity document or birth certificate, the caregiver's identity document and the child's clinic card as receipt of benefits is generally conditional on proof of immunisation. The applicant also needs to furnish proof of his own or his spouse's income. If the person is unemployed, he needs to furnish proof of that status. In the case of a non-parental primary caregiver proof is needed that he has permission to look after the child, as well as proof that the parents are dead or missing, if this is the case (GCIS Briefing 1999).

The complexity of the application process and the difficulties faced by, especially rural, people in obtaining documentation has proven to be an obstacle to the take-up of benefits and even led to the exclusion of needy people. As take-up has been proceeding so slowly, some of these requirements have been relaxed in order to encourage applications. For example, although proof of immunisation is supposedly a condition for the receipt of benefits, it has been decided that it will not be enforced to the point that it becomes punitive (Vorster and Rossouw 1997: 322).

Given these problems, the Lund Committee (1996: 92) found strong arguments in favour of a universal, rather than means-tested child support grant. In the first place it is the most administratively simple form of benefit. There would be a one-time information requirement of a birth certificate and thereafter, automatic payments for six years, thus avoiding the costs of repeated means tests. It would also be fairly efficient because, given South Africa's income distribution, relatively few non-poor people would be included. However, the pressure to reduce costs as much as possible led to the retention of the means test. It is also perhaps more politically and ethically satisfying, in a country with such extreme inequalities, to provide benefits only to the people who are worse off.

3.5. Perverse Incentives and Socio-economic Costs

As was discussed earlier, the structure and eligibility criteria of the state maintenance grants created a number of perverse incentives. The child support grant eliminates a number of these. In the first place, because the level of the benefit has been reduced, as has its duration, the disincentive to earn more income or increase labour supply is

substantially reduced. However, the elimination of the sliding scale may counteract this effect slightly because instead of a marginal reduction in benefit, those with an income just above the exclusion level stand to lose the entire benefit. Because the benefit is claimed by the primary care-giver there may perhaps be an incentive for the mother to increase her labour supply, leaving the child in someone else's care, as the person charged with caring for the child in the mother's absence can access the grant. On the whole, though, the benefit level is too low and the income cut-off level too high for very strong perverse incentives to be created. In other words, the people to whom an extra R100 per month would make the greatest difference are not earning at the exclusion margin.

It could be argued that the child support grant removes the incentive to reduce fertility as an additional grant is provided for each subsequent child, rather than a maximum of two children as was the case with the state maintenance grant. Realistically, though, the grant is set at too low a level and is of too limited a duration to have any significant effect on fertility levels. Nevertheless, the benefits are paid during the most dependent phase of children's lives, after which, particularly in rural areas, they can start to contribute to family subsistence and income-generating activities.

The Lund Committee recognised that the replacement of the state maintenance grant by the child support grant would not be without many social and economic costs (Lund Committee 1996: 95-96). Women who suddenly find themselves without or with reduced state support may struggle to find alternative sources of income. For many, the state maintenance grant represented the only reliable source of income within a pooled household budget (Vorster and Rossouw 1997: 323). Consequently,

many young people may be forced onto the labour market to support other family members. The role of retired family members in child-care will become even more important as will the financial support that their old age pensions provide to the multi-generational family. In addition, the role played by state maintenance grants in empowering women was very important: it raised their economic position vis-à-vis their spouses/partners, reducing dependence somewhat by raising their bargaining position within the household.

4. Take-up Rate

The phasing in of the child support grant commenced in April 1998 after which no new applications could be made for the state maintenance grant. All children of qualifying age would be eligible for a child support grant, not only those born after the 1998 implementation date. Although this was potentially more costly and administratively more challenging than including only children born after the date of first implementation, it was meant to ensure that as many children as possible would have access to the new grant in the shortest possible time.

Those families who were receiving state maintenance grants at the time of the introduction of the child support grant could continue receiving only the child allowance portion, and only up until the age of six years. Those who were older than six years at the time of the introduction of the child support grant were immediately excluded. The phasing out of the state maintenance grant was aided by a reduction in the benefit level, starting in 1997. In 1999, the child allowance was only R67 per month and in the year 2000 was further reduced to R30 per month (Germiston Welfare Office 1999). This provided a clear incentive to switch to the child support

grant. The old maintenance grant will have been completely phased out by the end of 2000 (Germiston Welfare Office 1999).

The phasing in of the new grant is proceeding much slower than was initially predicted. It was assumed that by the end of 1998, 2.5 per cent of the target population or 75 000 beneficiaries would have been reached. However, statistics for the end of 1998 indicate that only 8 552 grants were paid in that year (Ally 1998: 6). The main problem encountered is that applicants do not provide complete documentation, resulting in the delay of the application process (Department of Finance 1998a: 35). Figures released in September 1999 put the current number of beneficiaries at 150 000²⁶ (GCIS Briefing 1999). Take-up is low in the former homelands and rural areas, contrary to expectations of rapid expansion. In 1999, 170 553 parent's allowances (despite the official elimination of this component in 1997) and 227 768 child allowances were still being paid every month. The Department of Welfare acknowledges that take-up is still too low and "developing an appropriate strategy to reach the poorest of the poor has been difficult" (Ally 1998: 4). The aim is to expand coverage to three million children by 2003 (Republic of South Africa 1997 and The New Child Support Grant 1997: 2).

5. Articulation with Other Sources of Support

The child support grant is not the only source of support provided to young children. Examples of other financial transfers are foster-care grants and care dependency

²⁶ This figure is somewhat suspect as figures for 17 August were given as 100 000 (Parliamentary Briefing 1999). This implies an increase of 50 000 in 2 weeks (or a month). Given the slow progress up to this point, such a leap seems unlikely.

grants. Different government departments also offer non-financial support, such as free health-care, public works programmes to supplement the income of parents and nutritional support. Nor is the state the only source of financial support for vulnerable children and families. The judicial courts deal with private maintenance claims, customary law has its own traditional maintenance practices and, in the last instance, family and friends provide informal support. The role of non-governmental organisations (NGO's), community-based organisations (CBO's) and religious groups is usually limited to institutional care or the provision of services, such as day-care, that relieve the pressures of child support. The effectiveness with which these other forms of support operate contributes to the demands that are made on the child support grant.

5.1 Other Governmental Support

The foster care grant is payable to both non-relatives and relatives who are charged with the care of children. Foster care is intended to be a temporary placement, but because there is no subsidy for adoption there may be an incentive to continue foster-care status. The grant is set well above the level of the child support grant at R374 per month and is not means-tested. This is because fostering "...is not seen as a poverty issue; society recompenses some of the costs of a non-parent for caring for a child" (Lund Committee 1996: 80). However, a grant will not be paid if the child's income (from a trust fund or parental contributions, for example) more than twice exceeds the value of the foster care grant. Recent figures indicate that 46 696 foster care grants are paid every month (Department of Welfare 1998: 6) and the number of applicants is increasing. Like the child support grant, the foster care grant has proven very difficult for black families to access because of bureaucratic obstacles and the unreliable

payment of benefits. Moreover, fostering requires the official recommendation of a social worker, which is difficult to obtain in areas poorly penetrated by welfare services, and so many *de facto* foster parents are unable to access grants. It is very likely that the number of foster parents will increase significantly as the HIV/AIDS epidemic spreads and more children are orphaned by AIDS. There will be an increased need for an accessible, well-administered foster care grant.

The care dependency grant is paid to support children who require full-time care at home because of severe mental or physical impairments. The aim of this grant is to compensate for the extra costs borne by the family of a disabled child who is not in an institution. The working of the care-dependency grant is elaborated on in the chapter on disability grants.

Private or occupational insurance schemes do not provide any direct form of child support. Within the occupational unemployment insurance and workmen's compensation schemes consideration is given to the extra costs of children, though. The Unemployment Insurance Fund provides maternity benefits while the provision for survivor's benefits under COIDA can help families financially in the case of the loss of a breadwinner.

5.2 Private Maintenance through the Judiciary

Clearly private maintenance is not an alternative to social transfers in the sense that only women whose husbands have divorced or deserted them can apply for maintenance. Nevertheless, the number of single mothers in South Africa is so high that thousands of women would not have need of child support from the state if they

received their due maintenance from partners. Thus, the functioning of the private maintenance system has important implications for the number of recipients of the child support grants.

No longer do applicants for state child transfers have to submit proof that they have made unsuccessful attempts to obtain private maintenance. This was a large obstacle to the extension of benefits to those with limited access to the judicial system and who were less literate. Nevertheless, it is desirable that as much private maintenance as possible is paid in order to relieve some of the financial pressure on the state. The means test would disqualify most people receiving private maintenance from eligibility for a child support grant.

The process of obtaining private maintenance is difficult because the courts are notoriously inefficient. The following broad areas, especially, need to be improved:

- Private maintenance awards are very low, many of them below the Household Subsistence Level, which means that the state often has to be relied upon to supplement these awards. This in itself is not a problem. What is a problem is that the low awards may encourage people to bypass the courts altogether and apply immediately for the child support grant. Although partly a reflection of the low income of many applicants, the low level of awards is also partly due to the inefficiencies and administrative shortcomings of the judicial system.
- Most offices do not keep statistics on the number and nature of the maintenance cases they deal with (Lund Committee 1996: 51). Computerisation is limited and most computers are not linked to a common network with the result that, for example, payments and payouts must take place at the same office (Lund

Committee 1996: 52-53). The maintenance courts are also extremely busy: the Johannesburg office, for example, sees 250-300 people per day and deals with thousands of maintenance cases every month (Lund Committee 1996: 52).

- The attitude of the legal fraternity and Department of Justice has also been criticised. It is reported that the same energy is not devoted to maintenance issues as to other cases (Lund Committee 1996: 50). The Lund Committee goes so far as to say that this attitude has resulted in “effective apartheid” (Lund Committee 1996: 50).
- Considerable administrative and legislative discretion is applied when maintenance is awarded. There is no standardised questionnaire for measuring income nor guidelines as to the amount of maintenance that should be awarded. Also, the formula for the calculation of private maintenance awards is only based on the relative incomes of the two parents. It does not compensate the custodial parent for time and energy spent on child-care, life-style adjustments that must take place and, in particular, the fact that the she/he might be forced to enter the labour market for the first time.

Of course private maintenance is not an alternative for all single parents. It can never help those people whose partners are deceased, cannot be traced, are unemployed or too poor to support their children adequately. It is precisely these categories of people for whom the child support grant is designed. Nevertheless, the private maintenance system should be strengthened so that private maintenance is paid in all cases when it should be.

5.3 Customary Law

An alternative form of private maintenance is practised under customary law. “Isondlo”, paid in traditional communities, can be likened to a maintenance benefit and is loosely translated as “damages” (Lund Committee 1996: 61-62). Because an extra-marital child lowers the value of the “lobola” or bridewealth/dowry that can be demanded, “isondlo” is seen as compensation for the lower value attached to a woman who has given birth out of wedlock. It also compensates for the lowering of the family name and is paid to the parents. As such, the “isondlo” is not a direct contribution towards the maintenance of the child. A stronger form of informal maintenance is often negotiated by the parents of an unmarried couple and the man’s family usually absorbs the child or contributes financially to the woman. However, no statistics are available to indicate how widespread these practices are and to what extent they provide for the needs of the child.

5.4 Institutional Care

The state’s drive to reduce the number of children in institutional care creates a special need for cash transfers. Present policy aims to reduce the number of children in institutional care and subsidies for institutional care have been reduced (Republic of South Africa 1997). Institutional care was and is substantially more expensive than the provision of social transfers and, in addition, does not usually provide the same degree of nurturing and security as a family environment does. For example, in 1996, the Place of Safety Allowance during the enquiry for foster care cost R180 per month, subsidised residential care (where foster care was unavailable) cost at least R850 per month (Neilson and Gray 1997: 32) and hospitalisation for babies abandoned at birth

cost approximately R3 500 per month (Neilson and Gray 1997: 33). The now-familiar racial patterns are discernible in access to institutional care, except for coloureds whose admission to institutional care was particularly low because of specific government racially-motivated policy to promote foster care rather than institutional care among this group (Lund Committee 1996: 82).

5.5 Family Support

When all other possible sources of financial aid fail, families tend to turn to relatives and friends for assistance. Actually, in the extended families and close-knit communities that are typical of South Africa (and where awareness of and access to state benefits is not that high) relatives and friends are often the first line of support rather than a final resort. Some of the assistance is in the form of child-care and non-immediate family and friends often become the *de facto* permanent guardians of children while parents are away at work.

The existence of the extended family network draws attention to an important consideration in social security policy: by improving the financial position of extended family members such as grandparents and aunts and uncles, much can be done to improve the position of children. Disability grants and old age pensions received by family members, in particular, improve the welfare of society well beyond the original target population. Combined, in 1993, they constituted nearly a quarter of household income in “deep rural areas” and one third in rural households in KwaZulu-Natal (Lund 1994: 10) and, as more than half of households receiving social pensions had children in them (Lund Committee 1996: 7), this impact is quite significant.

6. Effect on Poverty and Redistribution

The child support grant should be more effective than the state maintenance grant as an instrument of redistribution and poverty alleviation. Not only will the child support grant reach more children than before, it will also combat poverty more effectively as the means test targets the most vulnerable 30 per cent of children in the relevant age group. Although many relatively poor people will now be excluded because the exclusion level of income is lower, the situation of the very poor will be much improved. Larger families tend to be on average, poorer, than smaller families and now, for the first time, they will be able to receive benefits for all their children. Thus, the benefit is progressive in nature. This effect is enhanced by economies of scale in larger families – the marginal cost of each additional child is less than the marginal benefit of the transfer. In particular, it is redistributive towards black people and rural areas, and especially in the poorest quintile an annual flow of R1 200 per young child from child support grants can have considerable impact (Van der Berg 1999c: 500).

The capacity of the child support grant to alleviate poverty and aid the development of young children should not be viewed in isolation. Already other social transfers, private and customary maintenance and institutional care have been examined. Also, the articulation with the social policies and programmes of other government departments should be taken into consideration. In particular, the grant contributes to goals of the Department of Health. Because it was found that many children are involved with health services at birth, but subsequently “disappear to the health system” (Lund Committee 1996: 93), the Department of Welfare encourages grant recipients to immunise and monitor the growth of their children. The free health-care provided to pregnant women and children under six should help to fulfil this

condition. The prerequisite of birth registration will aid the record-keeping of the Department of Home Affairs in the long run. Important synergies can be developed with the Department of Justice, too, as the pressure on the private maintenance system will inevitably increase as the more generous state maintenance grant is phased out, and strengthening the efficiency of the private maintenance system may reduce the need for state benefits. The Department of Education can also play an important role as the upper age limit of six years assumes that once in school, the educational system will provide the child with some alternative forms of support such as feeding schemes or clinic visits. Finally, there is a range of other programmes that complement the child support grant, e.g. a special education and income-generating Flagship Programme for Unemployed Women with Children 0-5, targeted public works programmes, nutritional interventions and corporate sector partnerships. Indeed, the idea of developing synergies between different support programmes is an important welfare priority. In a statement in 1997, the then Minister of Welfare Geraldine Fraser-Moleketi stated that "...the child benefit grant is not to be seen in isolation. It is intended as a form of support and to create a safety net, that is, to supplement other income and other programmes...one of the main assumptions underpinning the new grant is the dovetailing of various government programmes..." (Fraser-Moleketi, quoted in Vorster and Rossouw 1997: 324).

7. Conclusion

The South African social security system seems fairly well orientated to serving the needs of children. Social transfers, such as child support grants, foster care grants and care-dependency grants, seem to provide an effective safety net where household income is low, family support is insufficient and common and customary law fails

single parents. It is merely a safety net that is provided, though. The main benefit, the child support grant, is set at too low a level and offered for too limited a duration to have as great an effect on poverty alleviation in recipient families as the old state maintenance grant did. However, its design is such that it can potentially do far more to alleviate poverty among families with children. Any number of children in a household may receive the grant and the grant is directed at the primary care-giver of the child. The elimination of the sliding-scale reduces administrative costs and the low benefit level means that the grant is likely to remain fiscally sustainable. The biggest challenge now is to increase take-up rates so that the positive impact of these design elements can be felt.

CHAPTER 11

CONCLUSION - WHO FALLS THROUGH THE CRACKS?

1. Introduction

This thesis has considered the extent to which the South African social security system succeeds in providing protection to the population, both in the vulnerable periods of the life-cycle and against the major contingencies of unemployment, disability and disease. It has established that although the social insurance schemes provide a high degree of income security to their members, large numbers of people are excluded from membership because of their labour market status. Social assistance schemes only provide for certain social risks or conditions, and then are subject to a means test. Thus, the social security system is rather residual and incomplete in nature, and aims to complement other sources of income security, such as the private insurance market and the informal family and/or community network.

This chapter highlights those population or labour market segments that are left most vulnerable by the social security system. It then moves on to discuss three major issues that challenge the expansion of social insurance and social assistance to these groups. The expansion of social insurance, that requires formal employment for membership, is constrained by the high levels of structural unemployment and informal employment in the economy. Fiscal pressure limits the expansion of social assistance programmes. In addition, expected changes in the dependency burden, household structure and demographic variables, especially as the HIV/AIDS epidemic spreads, are likely to necessitate increased expenditure on social transfers.

2. Social Security at the Nexus of State, Market and Family/Community

Social security systems accord differential roles to the state, market and family in the provision of income security. The extent to which social security is needed to provide income security to the population depends on the nature and degree of protection provided by other sources, both state and non-state. This thesis has focused on state provision of social security in the form of cash benefits, but the state can enhance income security in other ways, such as through the provision of social services, non-cash benefits and tax incentives. Private sources of income support such as private savings or contractual savings through insurance funds play an important role, as does the financial support of the family and community.

2.1 Other Forms of State Support

Benefits-in-kind, such as food packages, subsidised housing, school feeding schemes and transport subsidies exist, but are not particularly widespread and so play a limited role in providing security. If more generous benefits-in-kind were provided to poorer households, some of these goods would not have to be purchased, leaving households with a higher level of disposable income. The more generous benefits-in-kind are, the lower the level of social grants that are needed to reach the same level of household welfare.

Social services, such as education, health care, social welfare services and family planning are generally subsidised, but not free of charge to all. Free primary health care is provided to pregnant women and children younger than six years, but at least some of the cost of most other public medical services must be borne by the patient.

The cost of primary and secondary education varies from school to school and tertiary education, although subsidised, is prohibitively expensive. Social services that provide for traditional family responsibilities such as day-care are absent, reducing incentives for female labour force participation, and expenditure on institutional care for the old and disabled has been cut back. Public schemes to promote employment, such as rehabilitation schemes and employment services, are in little evidence. Many of these services are provided by the private market, but market provision of these services is usually at too high a price to make a full range of services accessible to most of the population.

Another important area of state intervention for income security ends is via tax incentives. In South Africa the state influences investment in retirement funds, for example, by making contributions tax deductible up to a certain income, by exempting the investment income of pension funds from taxation and by its differential tax treatment of annuities and lump sum pay-outs. Tax incentives tend to be regressive in nature, however: the higher one's income, the more income tax one is exempt from.

2.2 Private Market Insurance

In the absence of sufficient protection by social security programmes, individual private savings provide resources to fall back on, thus minimising risk (Schmid, Reissert and Bruche 1992: 59).

Private sector insurance is widespread in South Africa and the provision of benefits through funds often occurs via the employment relationship. There are two main

categories of people who make use of private insurance funds. One group considers complementary private protection essential because of the ceilings on social insurance benefits. They opt for various saving and investment vehicles, such as retirement annuities as a top-up to social insurance because of the low replacement rate for higher income earners. The other group consists of those who work in sectors where occupational insurance schemes do not operate and for whom private insurance is the only means of income maintenance. Although compulsory social insurance exists in most sectors for old age, occupational injury and disease and unemployment, the private market is currently the only provider of health insurance.

2.3 Informal Social Security

The strong extended family network and multigenerational households that characterise most of South African society provide a safety net for those whom the social security benefits and social services of the state do not reach. The informal social security provided by the family and the community, rather than the state, is often the first line of support.

Beyond the family and the household, the community enhances security through other institutions, such as religious organisations and voluntary welfare organisations. There is widespread membership of revolving credit societies ("stokvels"), burial societies, feeding schemes and hundreds of independent churches that give support to the unemployed, chronically sick and the old (Kruger 1992: 216). In addition, there are non-financial sources of support such as the communal ownership of land and the sharing of foodstuffs. Non-governmental development and aid organisations also provide some relief.

The relationship between formal social security and informal family support is important. It has been argued that, in traditional communities with elaborate and extended family networks, social security can be inefficient in that it simply substitutes for natural altruism in the form of intra-family and community transfers. In countries with advanced social security systems, generous state support may have led to a reduction in family transfers (Atkinson 1983: 9). However, although different studies reveal different rates of substitution (Van der Merwe 1996: 40), it is clear that the social assistance benefits do not completely substitute for private altruism. Moreover, the same mechanism that transfers income/wages between family and community members also redistributes social grants, in particular old age pensions, enhancing their poverty-alleviating impact.

It is uncertain to what extent the informal family and community support network will continue to provide the support it does today. Traditional ties of solidarity are being eroded as household structures, demographic variables and labour market conditions change. The spread of HIV/AIDS has accelerated the breakdown of traditional sources of support.

3. Gaps in the Reach of the Social Security System

This section seeks to isolate those groups of people who fall outside the reach of the social security system. It will examine the coverage of the population, and in particular of the labour force, a) by contingency and the programmes that protect against that contingency, b) by income quintile and c) by race group.

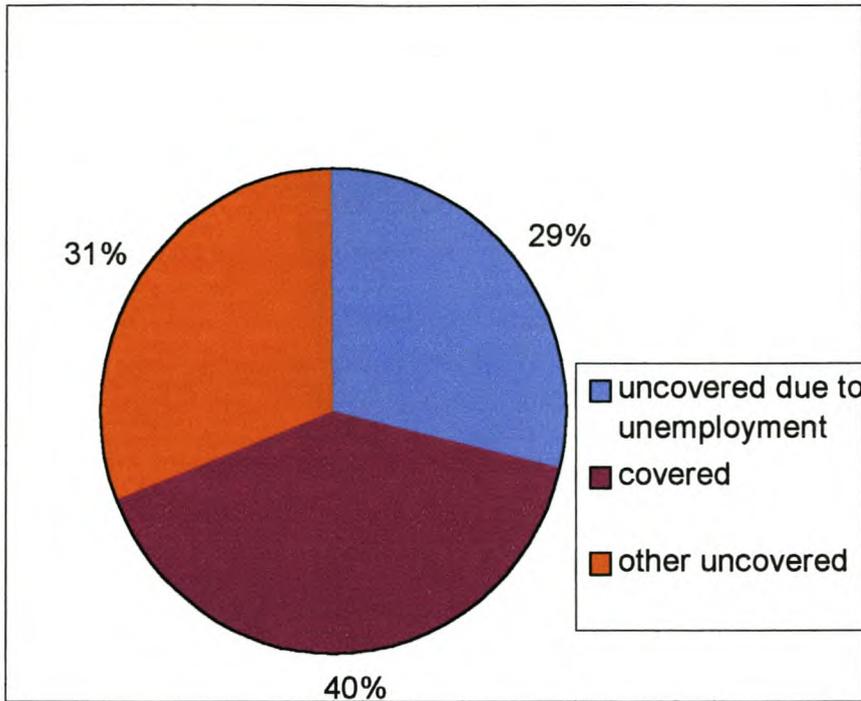
3.1 Coverage by Contingency

3.1.1 Old Age and Retirement²⁷

Chapter 3 noted that about 73 per cent of the formally employed are covered by occupational retirement schemes. However, widespread unemployment and the lack of coverage in certain sectors means that this translates into only some 40 per cent of the labour force (see Figure 11. 1). The unemployed, 29 per cent of the labour force²⁸, are excluded from retirement funds as formal employment is required for membership. A further 31 per cent of the labour force are employed in occupations, mainly in the agricultural, catering and accommodation, trade and domestic service sectors, that remain uncovered by retirement insurance agreements,

²⁷ Although retirement age and the age at which one becomes eligible for an old age pension do not necessarily coincide this assumption does not harm this analysis.

²⁸ Because data for employment in the major occupation groups was only available for 1995, the 1995 unemployment rate of 29.3 per cent is used in the pie charts.

Figure 11. 1 Coverage of the Labour Force by Occupational Retirement**Insurance, late-1990's**

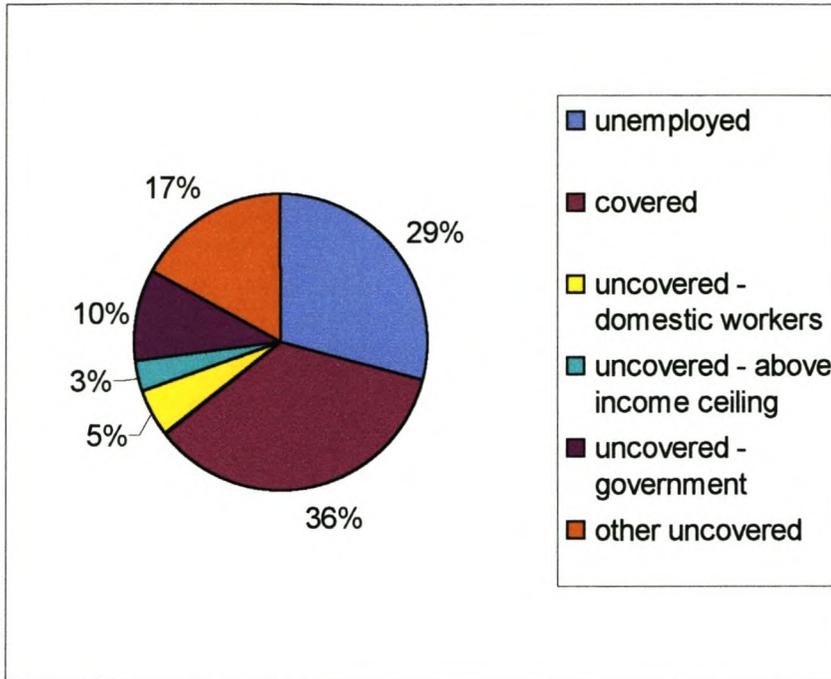
Most of those not receiving occupational retirement pensions will be reliant on the social old age pension. Altogether, approximately 80 per cent of the elderly population receive old age pensions. Some of these people draw occupational (social insurance) pensions simultaneously. These are people who, despite membership of retirement insurance funds, have failed to accumulate large enough occupational pensions due to, among other things, long periods out of employment, frequent job changes or the erosion of benefits by inflation. This is evidenced in data collected by the Smith Committee revealing that in 1993, 44.5 per cent of older persons benefited from retirement funds and 78.7 per cent from social pensions (Smith Committee 1995: D2.8), indicating some overlap. There are some people who do not draw occupational nor social pensions. These people either have enough private means to be excluded by the means test or they fail to take up the old age pensions for which

they are eligible. Nevertheless, retirement insurance membership is fairly widespread among the formally employed and take-up of social old age pensions, in general, is high. It would appear that the social security system caters rather well for the contingency of old age.

3.1.2 Unemployment

Approximately 36 per cent of the labour force contributes to the Unemployment Insurance Fund (see Figure 11.2). Government employees (10 per cent of the labour force), domestic workers (5 per cent of the labour force), casual and seasonal workers, contract workers, the self-employed and the informally employed are not eligible for membership. In addition to these sectors, those earning above the income ceiling of R97 188 per annum are excluded from membership of the Fund. Although it is the aim of the UIF to extend unemployment coverage to most of those currently excluded, especially to domestic workers, it seems unlikely that this will happen in the near future.

Figure 11. 2 Coverage of the Labour Force by Unemployment Insurance, late-1990's



As has been pointed out repeatedly, there is no social assistance that addresses the risk of unemployment. Consequently, the 64 per cent of the labour force that is uncovered or unemployed will receive no benefits during unemployment.

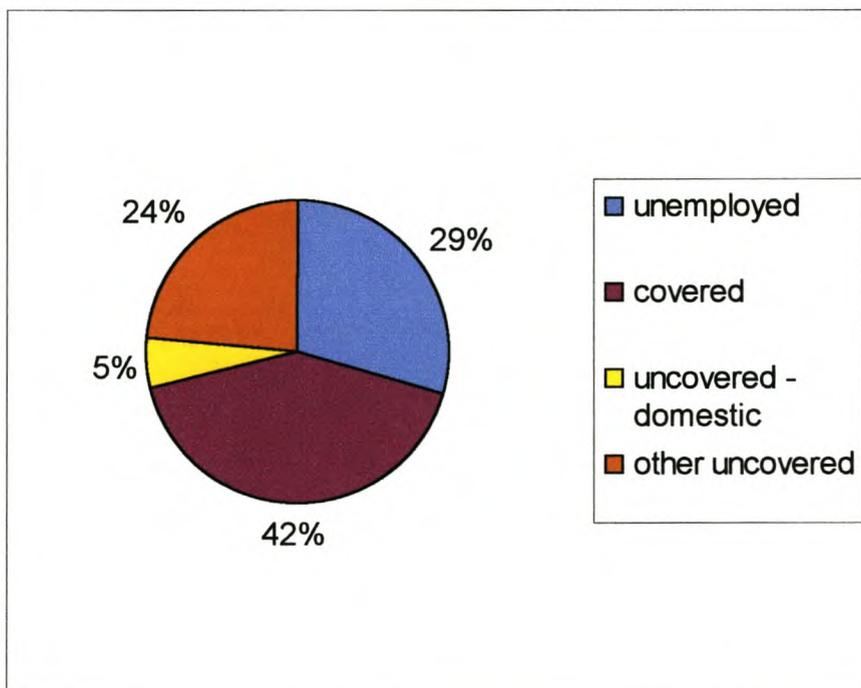
3.1.3 Disability

The extent of protection offered to different population groups against the contingency of disability depends on the context in which the injury or disease arises. Different social security programmes cater for disability or disease that arises in the workplace, in a road accident or from other sources.

All South Africans are entitled to loss of income benefits and medical benefits to compensate for injuries in road accidents. Although most benefits are capped, replacement rates are high enough to provide reasonable income security (at least to the innocent party) in any road accident.

Many formal sector employees are protected against injury or disease occurring in the work environment. About 42 per cent of the labour force contributes to the Compensation Fund (see Figure 11. 3). Casual workers are covered and there is no income ceiling, although benefits are capped. About 58 per cent of the labour force, including the unemployed, domestic workers, government employee, as well as the informal sector are excluded from membership. There is also a large percentage of the labour force that is protected against occupational injury and disease through their membership of the two mutual associations.

Figure 11.3 Coverage of the Labour Force by COIDA, late 1990's



For those people disabled in circumstances other than those mentioned above or who are employed in sectors that are not covered by COIDA agreements, the social disability grant provides some limited income support. Because it aims to provide a minimum safety net, rather than replace lost earnings, the R540 disability grant is set at a much lower level than benefits under COIDA. It can not compensate for the loss of earnings of a breadwinner in the most active period of the life-cycle. Take-up of disability grants varies significantly across provinces, across race groups and is especially low among women and rural people.

3.1.4 Childhood

The vulnerability of children in poverty-stricken households is recognised by the provision of a child support grant, subject to a means test. Take-up is currently low: in 1999, 150 000 care-givers of children in the targeted age group received child support grants. This number will increase to 3 million by 2003 if the Department of Welfare reaches its target take-up rate. Although it is a very small benefit that only caters to a very narrow age group, it can make quite a difference in large and poor households. Moreover, it seems to be the only level of benefit that is fiscally sustainable.

3.2 Coverage by Income Quintile

The social security system presently reaches those in the top 20 to 40 per cent of the income distribution (most of the employed outside of the agricultural and domestic sectors) through social insurance, and some of those at the bottom of the income distribution through social assistance (social old-age pensions, disability grants and

child support grants). However, there is a considerable portion of people in the middle and bottom of the income distribution that cannot be reached through the existing institutions. Moreover, of these, it is only those who fall victim to very specific contingencies, for example of old age or disability, who will receive some support from the state.

Table 11.1 shows the range of maximum social insurance benefits for which members of the different income categories are eligible²⁹³⁰. For example, someone earnings R1 500 per month would be eligible for unemployment insurance benefits of R675 (equivalent to 45 per cent of the wage). The benefits awarded by the Unemployment Insurance Fund and Compensation Fund are capped.

Most employees in the upper income groups contribute to social insurance funds and would be eligible for benefits, should the relevant contingency arise. People in the lowest two income groups are unlikely to be in stable formal employment and, therefore, unlikely to be members of insurance funds. Although not covered by social insurance, most people in the lower income groups are eligible for social assistance for the contingencies of old age and disability, but there is no social assistance or income support to provide protection against unemployment. For this and most other contingencies, they are reliant on small private savings and transfers from the incomes of family and the community.

²⁹ Due to a lack of appropriate data, the figures can not to be taken as quantitatively accurate, but nevertheless highlight some important points.

³⁰ In the case of compensation for occupational injury and disease, 100 per cent disability is assumed

Table 11.1 Coverage by Social Insurance, by Income Category of the Employed

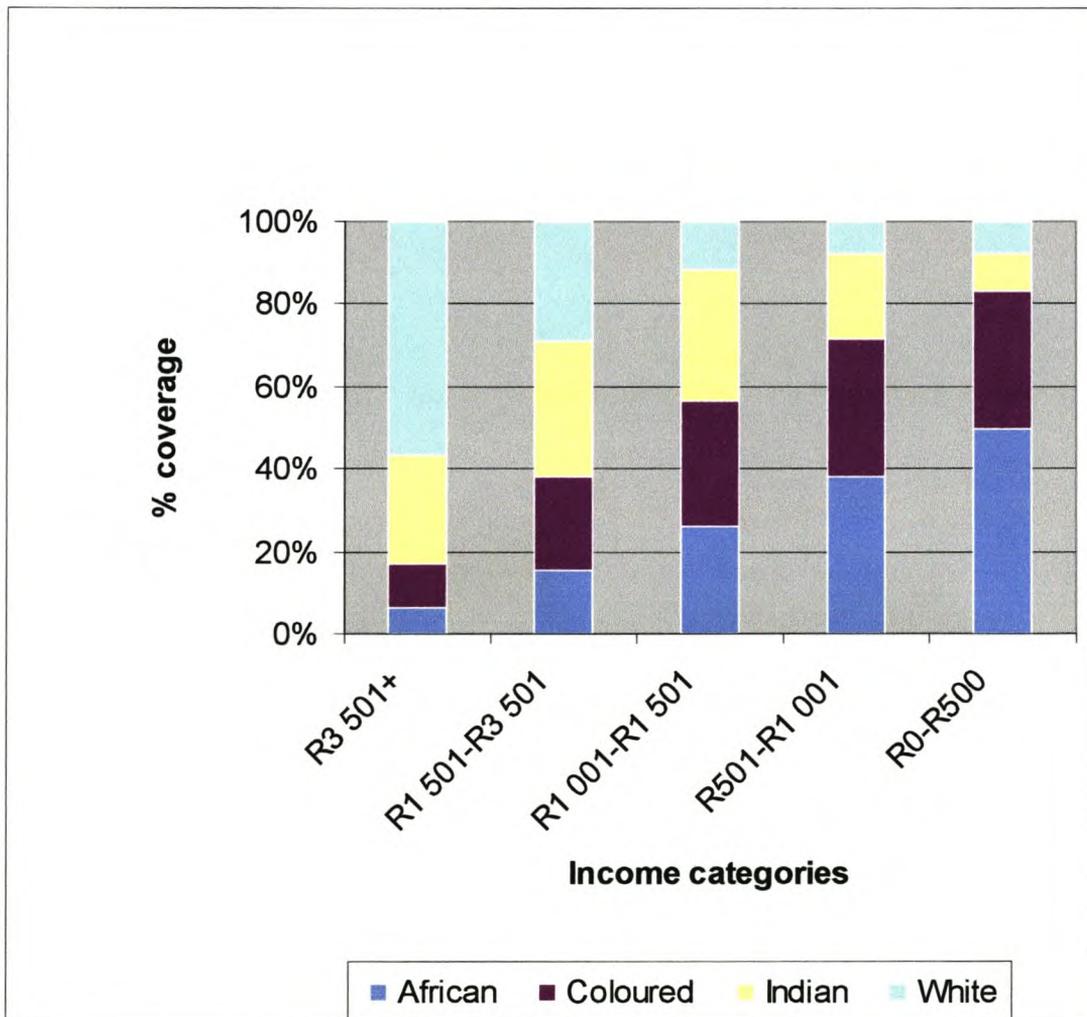
Income category	Occupational Retirement Funds	Unemployment Insurance	Compensation for Occupational Disability	Road Accident Fund
R3 501+	√	R1 575-R6 074	R2 625-R7712	√
R1 501- R3 500	√	R675-R1 575	R1 125-R2 625	√
R1 001- R1 500	√	R450-R675	R750-R1 125	√
R501- R1 000	X	X	X	√
R0-R500	X	X	X	√
Unem- ployed	X	X	X	√

3.3 Coverage by Race Group

If one looks at the spread of the different population groups across the income categories (in Figure 11.4), the lack of coverage by social insurance among the lower income groups becomes of particular concern. By disaggregating each income quintile by race, a rough indication is obtained of the coverage of each race group by social insurance schemes. The previous table (Table 11.1) revealed that it is predominantly employees in the upper three income groups who are covered by social insurance programmes. These three income categories are dominated by whites and Indians and include relatively few coloured and black employees. In addition, black

people form a disproportionately large share of the unemployed category- a category that cannot be covered by social insurance. Consequently, the black employed population is largely excluded from the reach of social insurance, either because of unemployment or because they occupy low-paid jobs in sectors uncovered by insurance agreements, while the Indian and, particularly, white population groups are relatively income secure.

Figure 11.4 Racial Composition of Employment, by Income Category



The fact that almost 90 per cent of social old age pensions are received by black people indicates that some of the gaps in coverage created by social insurance are

being filled by social assistance benefits, although at a much lower income level. The same can not be said of disability grants, however, where take-up among black people is much lower than is warranted by their disability prevalence.

3.4 Conclusion on Coverage

Social insurance largely only covers the employed as it is effectively occupational insurance, membership being conditional on regular monthly contributions by employers and employees. Many of those in formal employment are ostensibly covered against most contingencies, but only as long as their grasp on formal employment remains secure. As unemployment increases, many are unable to contribute to occupational or private insurance for old age or disability. Thus, through unemployment, a large portion of the labour force is automatically excluded from coverage by social insurance. Clearly, this further widens the welfare gap between those who have jobs and those who do not.

Within the risk categories that are covered, social security schemes tend to be selective in the particular segments of the population that they protect against these risks. Social insurance only serves the employed, and then, only caters for specific categories of the employed. Informal sector employees, domestic workers, contract and seasonal workers are generally excluded. As the black population is over-represented among these categories of employees, *de facto* discrimination exists in the provision of security through social insurance.

This is aggravated by the fact that little social assistance is provided to workers who are still in the productive phase of the life-cycle. Only in the event of disability are

significant benefits provided. Moreover, take-up rates of social assistance are low for many programmes, in certain geographic areas and among certain race groups.

Sections 4, 5 and 6 consider to what extent there is scope to expand social insurance and social assistance programmes to include the currently excluded groups, given South African labour market conditions, fiscal constraints and expected demographic change.

4. The Appropriateness of Social Security to South African Labour

Market Conditions

The previous section revealed that participation in social insurance programmes is crucially dependent on stable formal employment. Social assistance legislation concentrates on those who are not in the economically active period of the life-cycle, protecting against the social risks associated with childhood and old age, and those who are outside the labour force, due to disability. Moreover, as salaried employment opportunities in the formal sector are in short supply, an increasing number of people are being drawn into informal and self-employment or are involved in irregular and temporary employment activities – areas beyond the reach of social insurance. There is also no social assistance programme designed specifically for the contingency of unemployment and, consequently, the social security system does not succeed in providing a social safety net to some of the most vulnerable people in society.

Unstable and irregular employment is a feature of the South African labour market. Much work is of a temporary nature and people change jobs and employers fairly frequently. The social security system is not always appropriate to this because social

insurance benefits are not always portable, i.e. benefits cannot always be transferred to another fund when an employee changes jobs. Much employment is of a seasonal nature and can not be covered by social insurance because workers tend not to spend a long enough period in employment to be able to make regular payments to a pension scheme or accumulate sufficient credits for unemployment insurance. The old age social pension of the elderly is the only social assistance buffer and often maintains entire families out of season. The migrant labour system has also locked millions of people out of access to social security provision for retirement. The low wages and the nature of the contract have denied them the opportunity to contribute to a fund.

High unemployment together with a relatively unskilled labour force constrains economic expansion and job creation. In South Africa, social security policy only offers income support to aid the unemployed (on condition that contributions to an insurance fund have been made). It does not emphasise the retraining of the unemployed for new employment nor provide assistance with job search. A social security system that has a stronger orientation towards appropriate training for reemployment may lessen dependency on the social security system, increase employment and enhance the system's sustainability, rather than simply providing a short-term solution.

The trend towards self-employment and entrepreneurship could be encouraged if the self-employed were covered by social insurance. Social insurance or assistance grants would soften the blow of a temporary loss of income if the business should fail. It may also be possible for special programmes to be established whereby recipients of benefits are permitted, with training and support, to formally use their grant as start-

up capital or collateral in a micro-enterprise. Already the potential of such a scheme is evident in the important role played by the old age pension in stimulating enterprise. On the other hand, compulsory social insurance payments on behalf of employees raise the labour costs of the new entrepreneur wanting to enter the formal sector.

Thus, prevailing labour market conditions, in particular structural and rising unemployment, constrain the expansion of social insurance schemes.

5. The Fiscal Sustainability of the Social Security System

The sustainability of the social security system, specifically the social assistance schemes, depends largely on the state's fiscal position.

Other than in its role as employer, the state's involvement in the direct financing of social insurance is severely circumscribed. Its key role is to enable the establishment of some of the financing institutions, such as the national Funds, monitor the operation of these institutions and enforce employer compliance with social insurance legislation. Direct government expenditure on social insurance is limited to making up deficits and although this expenditure has been steadily increasing, it is not of great fiscal significance and poses no fiscal threat. A far more significant fiscal cost of social insurance is the cost to the state that results from tax income foregone due to tax incentives offered to employer and employees to contribute to social insurance funds. This runs into many billions of rands.

The cost of social assistance, however, is borne by the state whose future commitments depend on the ageing of the population, future benefit levels and any

changes to the means test. Funded by general revenue, social assistance schemes cost R16.8 billion in 1998/99 (Department of Finance 1998a). As discussed in Chapter 7, there does not appear to be much scope to increase the level of social assistance grants, other than to adjust for inflation. Increases in beneficiary numbers resulting from higher take-up rates should be sustainable, but it does not appear to be fiscally realistic to introduce social assistance schemes that protect against further contingencies, such as unemployment. Thus, fiscal constraints severely curtail any potential expansion of social assistance schemes.

6. Social Security and Changes in the Dependency Burden

Demographic change is an important exogenous challenge to social security systems. Factors such as population ageing, migration, population growth, changing family structure and the spread of HIV/AIDS alter the size and structure of the target population and, consequently, influence the types of programmes that would be most appropriate.

Two types of demographic change are of importance. Firstly, there are the macro-level population changes that affect the dependency ratio for society as a whole. The higher the dependency ratio, the smaller the proportion of the population that generates income, the lower output per capita and the narrower the tax base. Secondly, there are the micro-level changes in household structure which affect the dependency burden within households. The higher the dependency burden, the lower per capita household income.

South Africa has a youthful population structure with about half of the population under the age of twenty. This means that the dependency burden is relatively high with many children dependent on the incomes of relatively few adults who, moreover, face high unemployment levels. With so many children, a generous child support benefit across a wide age range is unaffordable. Assuming improved socio-economic conditions and a lower birth rate, as these children reach maturity a bulge in the adult age groups can be expected, reducing the dependency ratio. However, this may be offset by a high rate of HIV infection in young adulthood. Recent surveys do indeed capture a decrease in the size of the youngest black age cohort, though, which will no doubt intensify as the increasing incidence of HIV/AIDS reduces average female fertility ratios and raises 0-5 mortality rates.

Many countries, and especially the advanced industrialised countries, are facing the problem of demographic ageing and an accompanying high dependency ratio. South Africa's population is indeed growing older, but this is not of great concern in the medium term. While forecasts for the advanced industrialised countries project that, by 2010, 20 per cent of the population will be over 65 years of age, South Africa's figures are much lower at around 5 per cent (Lund 1998: 16).

Although South Africa does not face the problem of demographic ageing, the rapid spread of AIDS may have a similar net effect on dependency ratios. The impact of AIDS is worst felt in the economically active age groups. Consequently, older people may come to constitute a larger proportion of the population sooner than would otherwise be the case, increasing the dependency burden. The shrinking of the labour force will reduce the output available for consumption by all, thus reducing welfare

levels. Of course, this effect may be offset by other factors, such as South Africa's high unemployment rate. Although the labour force may shrink, the total number of the employed and, thus, total output may remain the same as the unemployed move in to take the jobs of AIDS sufferers.

Within households, two important effects can be distinguished. Firstly, the particular structure of South African households influences the form that social security programmes, and especially social assistance programmes, should take. Exogenous changes in household structure can occur, sometimes necessitating a redesign of social security systems. In South Africa's three-generational households in which the middle generation is frequently absent, the increasing number of children cared for by grandparents or extended family members is one of the factors that rendered the old child maintenance system increasingly inappropriate. Secondly, the very existence of particular social security programmes influences household structure and composition as members regroup themselves in order to derive maximum benefit from programmes. The generosity and regularity of social old age pensions relative to average income levels, for example, may encourage households to form around the income of elderly persons. Thus, not only does household structure influence the nature of social security benefits, but the design of social security systems can alter household structure.

The impact of HIV/AIDS at the household level is of particular concern. Although, the demographic effects are difficult to quantify accurately, some remarks on broad trends will illuminate points of specific importance to social security. By striking many of those in the economically active period of the life cycle, the disease will

affect the main income earners in families. This will increase the dependency ratio and place increasing demands on the income and time of other household members, plunging households into poverty. Increasing numbers of AIDS sufferers, orphaned children and child-headed households, combined with fewer economically active people will severely burden family support systems. Worst affecting women who live in poverty, AIDS will also erode the community support network and reduce the inter-household transfers that have offered some sort of income security to the unemployed and the vulnerable. Rural areas will be most severely affected.

As AIDS erodes both wage and community income support, the state may be called upon to provide residual assistance. Currently, there are no social assistance benefits available to adults who have become incapable of working due to AIDS. The large number of terminally ill and abandoned children will increase pressure on health care, welfare services and, if they are extended to cover HIV+ positive children, care-dependency grants. Of particular concern are the two million children that will be orphaned (by 2020) as their parents die from the disease. This will increase pressure on the foster care grant as increasing numbers of AIDS orphans are taken up by other households. As was shown in Chapter 10, the fiscal implications of this are enormous.

AIDS will also impact on the types of social insurance benefits paid out. A greater proportion of benefits will go to survivors. Retirement insurance benefits may be withdrawn early to support the ill member or be paid out to the spouse on the death of the member. The Unemployment Insurance Fund will pay out an increasing number of benefits as survivors' benefits to the family of deceased members.

7. Conclusion

Although the South African social security system has achieved a fairly advanced level of development and covers a fairly wide range of risks, a large number of people remain excluded from its reach. The challenge is to include those vulnerable members of society who still “fall through the cracks” in the provision of income security. However, there are a number of constraints facing its further expansion. Social insurance schemes provide generous benefits, but their membership is restricted to the employed. Expanding coverage by social insurance would require substantial growth in remunerative employment which, given prevailing labour market conditions, seems unlikely. The provision of more generous social assistance programmes catering for a broader range of contingencies is severely curtailed by already high fiscal expenditure on welfare and macroeconomic constraints. Moreover, changing demography, household structures and dependency burdens, especially as the HIV/AIDS epidemic spreads, seem likely to increase demands on social assistance programmes. Consequently, until employment can be expanded so that more people can contribute to their own income security, the informal social security provided by the family and/or community will remain the first line of support for many.

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