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South African Savings Institute

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Your Ref.	
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Direct Tel No.	+27 11 315 9197
Direct e-mail	info@finmark.org.za

Old Age Saving by Low-income South Africans

South Africa is in the process of reforming the systems through which it takes care of its elderly and destitute and encourages its residents to prepare for their old age. This reform will have far-reaching consequences for a large majority of South Africans, making it difficult to overstate the care with which this exercise should be approached.

FinMark Trust is dedicated to finding ways to make financial provision more accessible to the poor, whether this provision is provided by the private sector or public. With this in mind, together with the South African Savings Institute, FinMark Trust initiated a study to understand better whether and how South Africa's poor make financial provision for their old age.

The objective of this study is to understand the mix of mechanisms employed by South Africa's poor to provide for old age and to identify the policy priorities needed to meet their needs more effectively. This motivation is consistent with the goals of both organisations to contribute constructively to the development of a policy framework that is in the interests of all South Africans, particularly those with lower income.

Genesis Analytics carried out the research and their report is enclosed. The purpose of this short note is to summarise the key aspects of that research and to consider their implications. Comments on the findings of this study are most welcome and should be directed to Rob Rusconi, technical adviser to FinMark Trust, who can be reached at rob@tresconsulting.co.za.

Key insights

The most important lessons Genesis derived from the research may be summarised as follows:

- **Low-income South Africans save very little for retirement.** According to FinScope SA 2005, around one-third of the working age members of LSM[1] 1-5 save at all, but only 5 percent of them say that they actually save for retirement. A proportion of this group is likely to save because they are required to do so by their employer, which means that very few people in this part of the socio-economic spectrum save voluntarily for their retirement.[2]

[1] Living Standard Measure (LSM) is a system of categorization utilized in South Africa to provide differentiated socio-economic groupings. It is not based on, but is highly correlated to income.

[2] This appears to contradict the findings of the Financial Diaries project that finds apparent evidence of considerable saving activity. The key to the conundrum probably lies in the use of the word savings. The often sophisticated and

FINMARK TRUST P O Box 61674 Marshalltown 2107 Republic of South Africa
▲ Ground Floor Howick Gardens Waterfall Park 84 Bekker Road Vorna Valley 1686
Tel +27 11 315 9197 ▲ Fax +27 86 518 3579 ▲ E-mail info@finmark.org.za ▲ www.finmark.org.za
▲ VAT no. 4710213044 ▲ ITrust 4167/02/92

- **The State Old Age Grant (SOAG) represents by far the most important source of income of South Africa's elderly poor.** FinScope SA 2006 reports that some 89 percent of older (age sixty or more) members of the LSM 1-5 group receive their income from the grant while the remaining 11 percent say that they receive most of their income from family and friends, or simply have no income. Of this 11 per cent, very few have any form of employment-based or personal pension saving.
- **Significantly fewer South Africans will reach retirement age.** The statistical life expectancy of twenty-year olds has fallen dramatically. While at the time of the democratic transition in 1994, twenty-year old women could expect to live, on average, to 71 and men to 63, in 2007, the life expectancy for twenty-year old women is well below 60, and for men below 55. This is reflected in the attitudes that working age South Africans have towards preparing for retirement.
- **The already low employment rates among low-income South Africans fall off rapidly from age 45.** General Household Survey data shows employment levels among the LSM 1-5 group at around two-thirds in the late 40s, falling to around 60 percent in the early 50s and less than 50 percent in the five years up to age 60. Those who describe themselves as 'economically inactive' correspondingly rise from 15 percent in their late 40s to 40 percent ten years older. Unemployment rates like these exacerbate the very low marginal propensity to save for the medium- to long-term.
- **Very low employment levels result in income at working age lower than the corresponding income for retired people**. Average personal income in every category from LSM 1 to LSM 5 is lower for working age members than it is for their retired counterparts. While this speaks volumes for the potential for the SOAG to meet the future needs of younger generations, it accentuates the low potential for working age members of the LSM 1-5 group to save: if the SOAG is considered an adequate income for retirees, by definition the incomes of those still working in LSM 1-5 must be considered inadequate even for basic needs and therefore a fragile basis for long-term savings activity. It also undermines the traditional intergenerational contract, under which parents educate their children at least partly to enhance the ability of these children later to sustain their parents in their old age.

These points describe some of the characteristics of working and elderly lower income South Africans, but they do not completely explain the very low rates of long-term saving.

Nature of the savings problem

Genesis describes these very low rates in terms of a number of hurdles. Each needs to be overcome in turn by a lower income South African who might be determined to save.

- **Myopia.** Individuals of all socio-economic classes suffer a short-sightedness that makes it difficult to give up present consumption to save for a very long-term future. As lifespan is positively correlated to socio-economic status, lower income South Africans may be even less inclined to save for their old age.
- **Affordability.** Lower-income South Africans have, by definition, poorer means. But they are also more exposed to risks and much less able to manage them, either through insurance or spare resources to overcome these set-backs. Informal insurance arrangements tend also to take any excess assets, as many in this group readily contribute to the immediate needs of their neighbors in the knowledge that they are likely to benefit similarly when beset by difficulty.
- **State provision and the means test.** While the existence of the SOAG should not reduce the marginal propensity to save, the means test on the state grant almost certainly would. Working age South Africans of poor means are rationally motivated <u>not</u> to save by the existence of a test that would reduce the benefits to which they are eligible from the state.
- **Priority of alternative mechanisms.** The focus groups highlighted the existence of competing forms of saving, notably education and housing. While educating children is by some seen as an unavoidable obligation, others regard it as a means of providing for an uncertain future by equipping children with the power to work and earn. Less ambiguous was the message on housing. This is seen by the majority of

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complex stokvel activity addresses risks and manages short-term cash needs, but it does not constitute long-term saving as defined by FinScope and as understood for the purposes of this study.

South Africans as a valuable, tangible and even flexible means of providing for an uncertain long-term future.

- **Inappropriateness of many product vehicles.** The research suggests that, with these hurdles in mind, it should not be a surprise that take-up of existing long-term savings products (such as endowments) is low. They generally do not provide the flexibility to put periodically available disposable income away or to access significant parts of the accumulated saving in the event of emergency.

In sum, lower income South Africans do not save for the long-term because they do not see it as a priority, cannot easily afford to forgo current consumption and prefer to prioritize tangible long-term objectives like piece-meal housing development and the education of their children. They are discouraged by the disincentive of the means test and they find available products expensive, inflexible and unwieldy.

Policy considerations

This research raises a number of implications. First, and probably most simply, the means test needs to be dismantled or significantly modified, because it removes any motivation that this large but economically marginal group may have to prepare more actively for an uncertain future.

Second, compulsory saving may be misplaced, even if it were to apply only to the formally employed members of this group and were supported by explicit cash incentives of one type or another. Why, if the SOAG is considered an appropriate income for retirees, should we expect people of working age, who earn less, to part with income that may be meeting basic needs? Incomes in LSM 1-5 do not seem to deliver much more than a hand-to-mouth existence and so the burden of mandatory saving might be intolerable. It would remove assets from the community as a whole, significantly undermining the informal insurance arrangements that may keep many people afloat in times of great difficulty.

Third, we need to define saving more broadly. The conventional cash-based definition of savings, as understood by the financial industry in terms of contributions to a policy, unit trust or government vehicle, seems to resonate very little with poorer people who value the more tangible aspects of saving in the form of incremental housing or education. Perhaps contributions to the cost of children’s education or to the development of housing could be considered part of the formal saving effort and even receive a form of government subsidy, as the innovative Fundisa education initiative does at present.[3] If a house is regarded by many lower income South Africans as a good investment for the future and therefore part of a rational saving strategy – something that is not questioned in the higher income population segments – perhaps policymakers and private sector providers could be brought around to this perspective as well.

Fourth, policy must be thought of holistically. As difficult as it may be, the many strands of government efforts to improve the long-term position of lower income South Africans must be considered together.

We trust that this research will provide valuable input to all South Africans interested in doing the best for this numerically very significant but largely voiceless part of our population. We value your comments.

Yours sincerely,

Mark Napier
Chief Executive Officer
FinMark Trust

Elias Masilela
Chairman
South African Savings Institute

[3] The research demonstrates the priority placed on educating children, whether in expectation of future reward or not. While classical economic theory counts as investment only those vehicles or actions that are asset accumulating, perhaps the rational use of resources on educating children should be considered part of investment and saving. The research suggests that it is considered a priority above other more conventional saving mechanisms.