

South Africans contributing towards a pension: evidence from the Labour Force Survey¹

Prepared by

Elias Masilela (Sanlam) and Sheshi Kaniki (Momentum)

January 2009

¹ Our heartfelt appreciation goes to Rashad Cassim, Kefiloe Masiteng and Malerato Mosiane of StatsSA for data support

1. INTRODUCTION

One of the objectives of the current pension fund reform process is to increase coverage within the formal and informal sectors. In the 2004 Discussion Paper from the Treasury, it is said:

“Though there is wide coverage in South Africa of those in employment, by international comparison, many people lack effective access to an affordable retirement funding vehicle. This relates to the structure of the economy – South Africa has a high rate of unemployment, a large informal sector, and many working-age individuals who have periods of unemployment scattered throughout their working lives. These features have to be taken into account in considering retirement funding reform options....” Pg6

It will also be recalled that this has been one of the key considerations for many societies that have walked down the reform path as we will be doing in South Africa soon. Unfortunately, this becomes a very tricky challenge later on in countries' reforms, particularly where the economy is characterised by a large informal economy. Chile has not improved informal economy coverage after 27 years of their third wave of reform. Hopefully, South Africa will fare better owing to our experience in this area from the UIF implementation programme.

It is instructive to note that the issue of coverage is not unique to developing economies. A very recent report shows that occupational coverage has been static in Germany over the past three years. The figure currently stands at 52% in 2007.

However, that developing economies are also exposed to the same ought not to give us any comfort. This comparison is actually misplaced, as it compares uncomparables – economies with a comprehensive social security net against South Africa's fragmented one. This comparison was done merely for academic reasons.

Against this background, this note aims to quantify the extent to which South African workers are contributing towards a pension, as well as provide an indication of the number of people likely to be brought into the net. The key question, is, “Should we really be investing the envisaged effort in this exercise of reforming the industry?” The relative proportion of people outside of the net will provide a good indication of the magnitude of the problem that needs to be solved by the reform. The analysis hopefully, will also provide an indication of the new assets that will be generated by the widening of the net.

Increasing coverage will require an understanding of what the existing pension status of South Africans is - across different income groups. This is not only important for the financial impact of the reform but it will also help us understand its social implications.

2. THE LABOUR FORCE

Table 1 shows the income distribution of persons employed in the formal and informal sectors aged 16 and above for the period 2005 to 2007. The majority of employees are found in the formal labour market. In 2007 only 8.39% of the labour force was in the informal sector. The relatively small number of people in the informal sector suggests that expanding the pension net to include them is attainable if sufficient resources are set aside to implement a well designed strategy. In 2007 an estimated 1.88 million workers in the formal sector (35% of formal sector employment) earned between R501 and R3, 500 per month. The corresponding figure for the informal sector was 63,000 (64% of informal sector employment). On a cumulative basis, about 77% of people employed earn below R11, 000.

Table 1: Income distribution of employed persons (aged 16 and above)

Income Group	LFS Sep 2005:2		LFS Sep 2006:2		LFS Sep 2007:2	
	Formal	Informal	Formal	Informal	Formal	Informal
None	7	1	6	1	7	3
R1-R200	73	81	44	64	56	38
R201-R500	287	231	215	169	217	136
R501-R1 000	1 128	308	1 024	305	926	224
R1 001-R1 500	969	140	1 040	161	962	114
R1 501-R2 500	1 396	111	1 484	128	1 592	149
R2 501-R3 500	873	29	964	28	1 039	34
R3 501-R4 500	601	16	703	9	763	17
R4 501-R6 000	637	12	654	4	765	8
R6 001-R8 000	515	7	540	6	623	8
R8 001-R11 000	460	3	488	4	571	6
R11 001-R16 000	254	4	323	1	366	4
R16 001-R30 000	157	2	228		245	1
R30 001+	75		73		242	2
Don't know	191	15	183	7	226	11
Refuse	414	11	418	12	480	8
Unspecified	7	1	35	1	79	6
Total	8 043	973	8 422	901	9 159	768

Source: Calculations based on Labour Force Survey

Note: For all values of 10 000 or lower the sample size is too small for reliable estimates

The cumulative income distribution of all persons employed in the formal and informal sectors is shown in Table 2. The proportion of employees earning R2, 500 per month or less decreased from 52.49% in 2005 to 44.57% in 2007. This suggests that nominal incomes are increasing. Based on the cumulative increases, the largest single group is those earning between R1, 501 and R2, 500. Table 2 also shows that the majority of these employees earned R3, 500 or less in all three years. The cumulative increase at the highest income level is marginal, about 2.5% in 2007.

Table 2: Cumulative income distribution of all employees in formal and informal sector (aged 16 and above)

Income Group	LFS Sep 2005:2	LFS Sep 2006:2	LFS Sep 2007:2
	Total Cumulative	Total Cumulative	Total Cumulative
None	0.09%	0.08%	0.11%
R1-R200	1.80%	1.24%	1.06%
R201-R500	7.54%	5.36%	4.61%
R501-R1 000	23.48%	19.62%	16.20%
R1 001-R1 500	35.77%	32.50%	27.03%
R1 501-R2 500	52.49%	49.78%	44.57%
R2 501-R3 500	62.49%	60.43%	55.38%
R3 501-R4 500	69.33%	68.07%	63.24%
R4 501-R6 000	76.53%	75.13%	71.03%
R6 001-R8 000	82.32%	80.98%	77.38%
R8 001-R11 000	87.45%	86.26%	83.20%
R11 001-R16 000	90.32%	89.73%	86.92%
R16 001-R30 000	92.08%	92.17%	89.39%
R30 001+	92.91%	92.96%	91.85%
Don't know	95.20%	95.00%	94.24%
Refuse	99.92%	99.61%	99.15%
Unspecified	100.00%	100.00%	100.00%

Source: Calculations based on Labour Force Survey

Note: For all values of 10 000 or lower the sample size is too small for reliable estimates

Table 3 compares the cumulative income distribution for formal and informal employees.

There is a significant difference between the two groups. In 2005, 2006 and 2007 the percentage of informal workers earning below R2, 500 was 89.7%, 92.0% and 86.5% respectively. This is in stark contrast to the corresponding figures for the formal sector: 48.0%, 45.3% and 41.1%. Clearly, the capacity to save for retirement is substantially lower in the informal sector compared to the formal sector. Targeted measures will be required to stimulate retirement saving by the informal economy.

Table 3: Cumulative income distribution for formal and informal employees (aged 16 and above)

Income Group	LFS 2005:2		LFS 2006:2		LFS 2007:2	
	Formal	Informal	Formal	Informal	Formal	Informal
None	0.08%	0.13%	0.08%	0.12%	0.08%	0.43%
R1-R200	0.99%	8.49%	0.59%	7.25%	0.70%	5.39%
R201-R500	4.56%	32.20%	3.15%	26.03%	3.06%	23.11%
R501-R1 000	18.59%	63.89%	15.30%	59.91%	13.17%	52.22%
R1 001-R1 500	30.63%	78.28%	27.65%	77.82%	23.67%	67.04%
R1 501-R2 500	47.98%	89.70%	45.27%	91.99%	41.05%	86.46%
R2 501-R3 500	58.84%	92.72%	56.72%	95.12%	52.40%	90.93%
R3 501-R4 500	66.30%	94.38%	65.07%	96.11%	60.73%	93.17%
R4 501-R6 000	74.23%	95.61%	72.83%	96.55%	69.08%	94.23%
R6 001-R8 000	80.63%	96.30%	79.25%	97.18%	75.89%	95.24%
R8 001-R11 000	86.35%	96.61%	85.04%	97.62%	82.12%	96.04%
R11 001-R16 000	89.50%	97.04%	88.87%	97.71%	86.11%	96.51%
R16 001-R30 000	91.46%	97.25%	91.58%	97.74%	88.79%	96.59%
R30 001+	92.39%	97.25%	92.44%	97.74%	91.43%	96.84%
Don't know	94.77%	98.78%	94.61%	98.55%	93.90%	98.25%
Refuse	99.92%	99.91%	99.58%	99.87%	99.14%	99.25%
Unspecified	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Source: Calculations based on Labour Force Survey

Note: For all values of 10 000 or lower the sample size is too small for reliable estimates

3. PENSION STATUS OF THE LABOUR FORCE

Table 4 shows the percentage of all employed persons in the formal and informal sectors contributing towards a pension by income.

As expected, there is a strong positive correlation between income and pensions – a higher percentage of contributors are found among those earning higher incomes. This indicates that the reform objectives are correct to prioritise mechanisms that will stimulate pension contributions by low income earners.

However, what this data does not tell us, is how much of people's income goes into retirement savings. Ultimately, the reform has to ensure that people are not just saving – but are saving adequately for their retirement. This is a question that will have to be answered by another analysis, to test the stability of the seeming significant positive marginal propensity to save. The comfort that we may draw from this analysis, even though inadequate to answer all questions, is that the psychology of the consumer is in the right space and direction. It would be grossly concerning had the data revealed a different picture.

Table 4: Formal and informal sector employees contributing to a pension by income group ('000), (aged 16 and above)

Income Group	LFS Sep 2005:2		LFS Sep 2006:2		LFS Sep 2007:2	
	Employed	% with pension	Employed	% with pension	Employed	% with pension
None	7.86	0.98	7.54	4.71	10.78	3.78
R1-R200	154.12	13.13	107.88	7.87	94.43	10.10
R201-R500	517.92	13.47	384.12	8.95	352.67	11.83
R501-R1 000	1436.87	17.60	1329.21	15.97	1149.99	15.48
R1 001-R1 500	1108.62	41.02	1201.39	29.61	1075.55	27.94
R1 501-R2 500	1506.78	55.87	1611.21	49.34	1740.97	43.27
R2 501-R3 500	902.39	73.46	992.73	74.08	1073.67	66.40
R3 501-R4 500	616.70	81.82	712.21	79.55	780.14	78.92
R4 501-R6 000	649.15	83.63	657.72	82.84	773.19	79.16
R6 001-R8 000	521.58	86.87	545.68	88.86	630.66	86.16
R8 001-R11 000	462.97	91.19	492.02	89.35	577.35	86.41
R11 001-R16 000	258.01	87.45	323.36	87.82	369.22	90.57
R16 001-R30 000	159.24	91.07	228.20	84.12	245.23	87.57
R30 001+	74.99	75.39	72.93	88.50	244.01	83.45
Don't know	206.28	44.16	190.10	53.38	237.01	45.64
Refuse	425.10	74.64	430.16	72.99	487.93	71.50
Unspecified	7.60	30.29	36.39	34.34	84.32	34.68
Total	9016.20	56.15	9322.84	55.20	9927.12	55.46

Source: Calculations based on Labour Force Survey

Note: For all values of 10 000 or lower the sample size is too small for reliable estimates

However, pension coverage among higher income groups is not as high as one might have expected. For example, in 2006 close to 16% of those earning between R16, 000 and R30, 000 did not contribute towards a pension. From 2006 to 2007 those earning above R30, 001 that did not contribute to a pension, increased from approximately 11.5% to about 13.5%. This suggests that extending coverage is not an issue of relevance only to low income earners. Given that there is substantial scope to increase the participation of high income workers, the new system has the potential to generate a large asset base.

The percentage of working persons in the formal and informal sectors contributing towards a pension is shown in Figure 1.

There is a very large discrepancy between the two sectors. Whereas coverage in the formal sector is in the region of 60%, it is only around 10% in the informal sector. Figure 1 also shows that there was a decline between 2005 and 2007 in the percentage of formal sector workers contributing towards a pension. The percentage of those contributing in the informal sector was relatively erratic over this three year period.

Data for the first two quarters of 2008 shows that participation continued to decline across the board. This may be attributable to growing uncertainty and the economic slowdown that began sharply in the first quarter. Total participation for the two sectors declined to below 52% compared with 56% in 2005. With the economic impact of the global financial crisis taking grip over performance and employment, there is a growing likelihood that this figure will become worse over the next year or so.

Figure 1: Percentage of employed persons contributing towards a pension by sector (aged 16 and above)

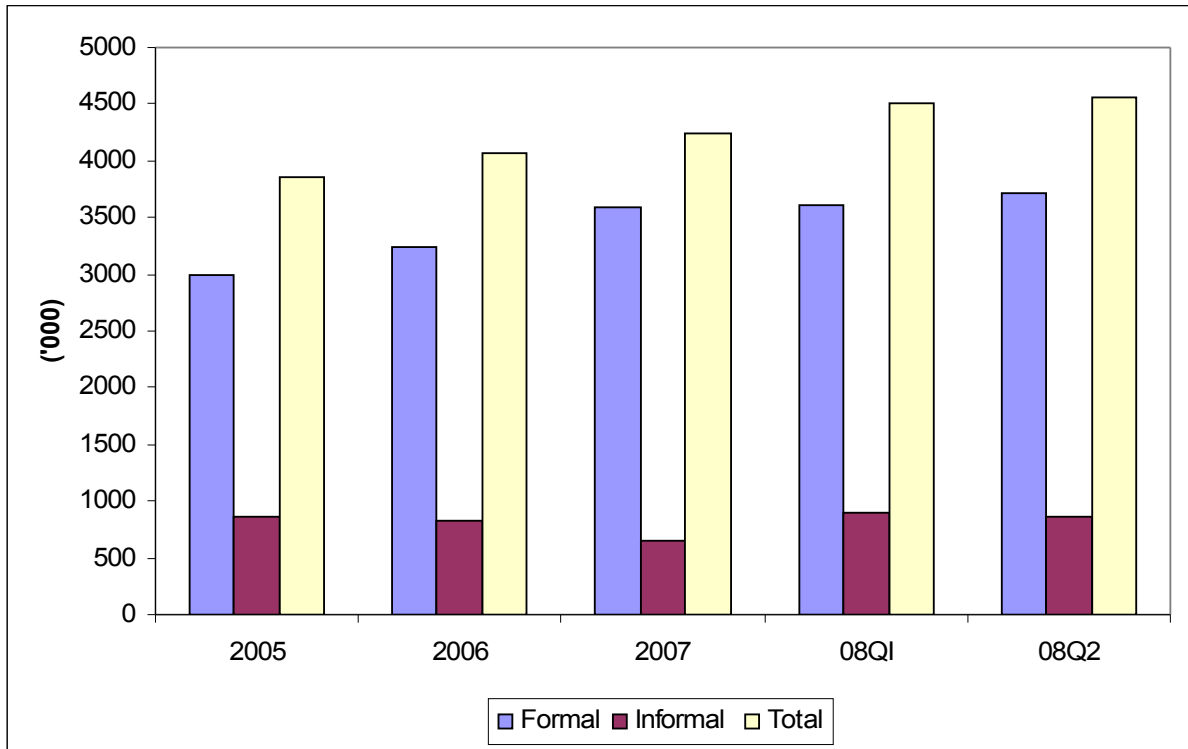


Source: Calculations based on Labour Force Survey

Note: For all values of 10 000 or lower the sample size is too small for reliable estimates

This declining coverage rate translates into a growing number of working South Africans with no pension arrangement. This is shown for the formal and informal sectors in Figure 2, whereby this number has risen steadily from about 3.8 million in 2005 to over 4.5 million in quarter 2 of 2008. A consistent annual increase in formal sector workers with no pension has been a main driver of this trend.

Figure 2: Number of employed persons in formal and informal sectors with no pension (aged 16 and above)

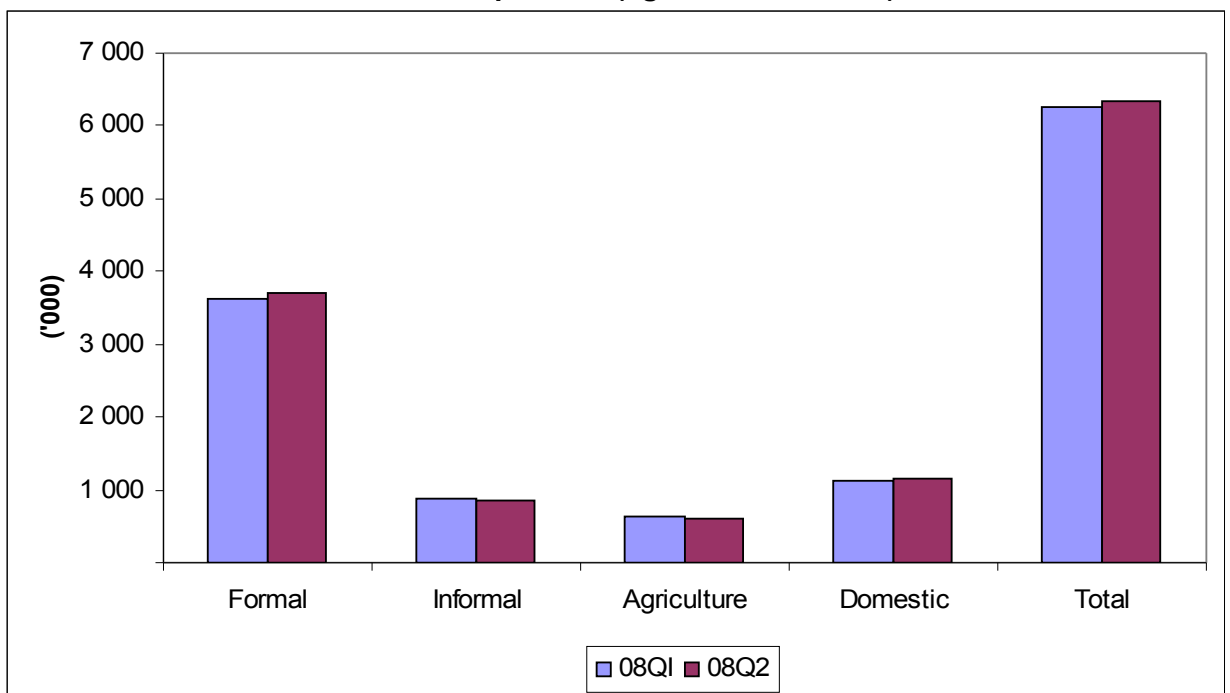


Source: Calculations based on Labour Force Survey

Note: For all values of 10 000 or lower the sample size is too small for reliable estimates

The data for 2008 makes it possible to examine the domestic worker and agricultural sectors in addition to the formal and informal sectors. Figure 3 shows that 6.3 million workers had no contributory pension arrangement in the second quarter of 2008. This accounted for 54% of all employed persons aged 16 and above.

Figure 3: Number of employed persons in formal, informal, agriculture and domestic sectors with no pension (aged 16 and above)

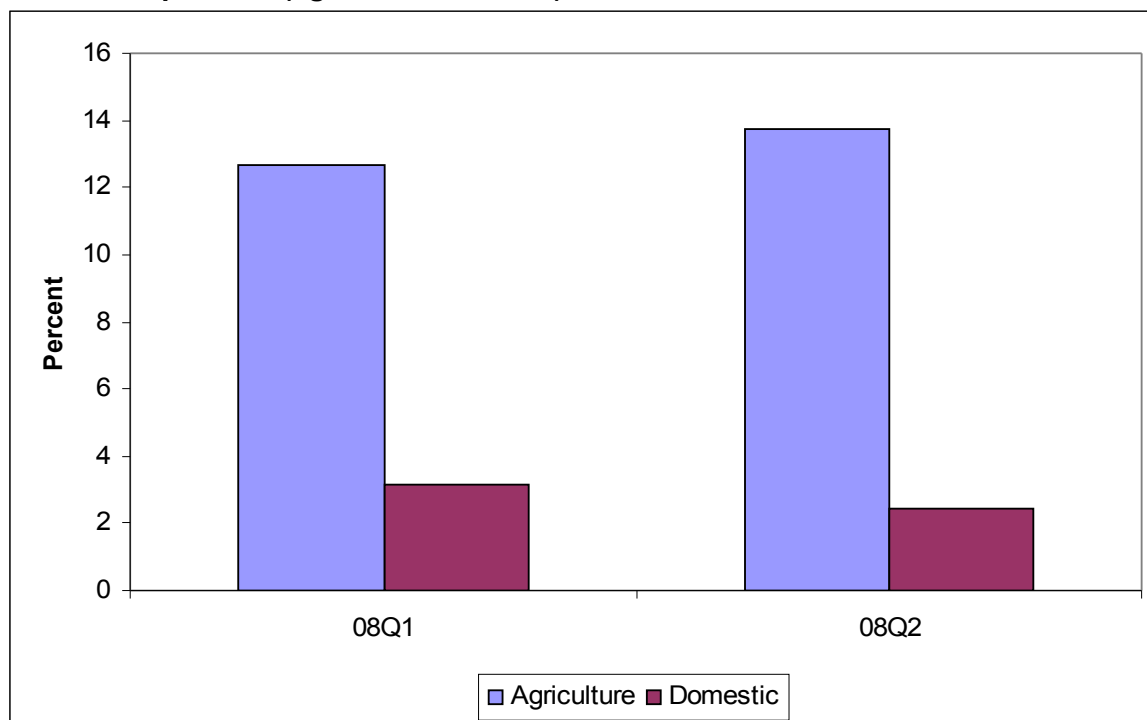


Source: Calculations based on Labour Force Survey

Note: For all values of 10 000 or lower the sample size is too small for reliable estimates

The proportion of agricultural and domestic workers contributing towards a pension is shown in Figure 4. This data is only available for 2008. Nevertheless, Figure 3 presents useful information on these two groups. The participation of these groups is consistent with the low incomes they receive.

Figure 4: Percentage of agriculture and domestic workers contributing towards a pension (aged 16 and above)

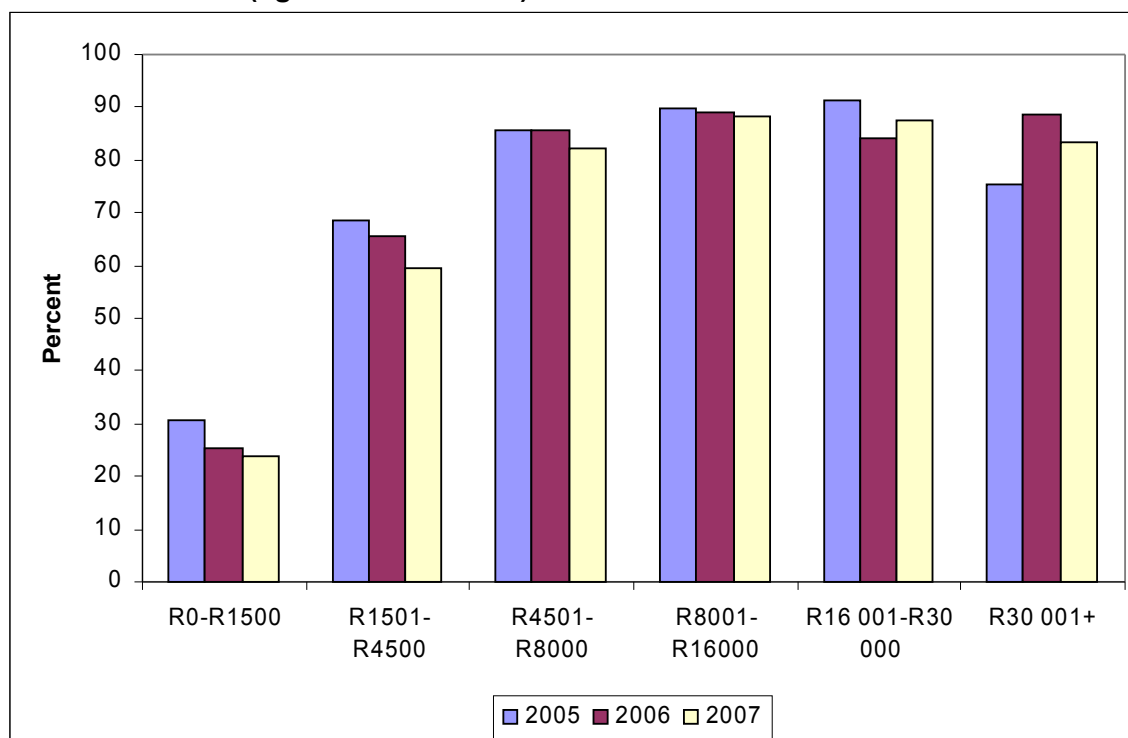


Source: Calculations based on Labour Force Survey

Note: For all values of 10 000 or lower the sample size is too small for reliable estimates

Figure 5 shows that a higher proportion of high income formal sector workers contribute towards a pension compared to low income workers. It also shows a decline in the percentage of formal workers contributing towards a pension from 2005 to 2007. This decline appears to be more significant among lower income workers. The reform process will need to focus not only on reversing this trend, but also on addressing the underlying reasons for it. Fundamentally, the reversal of this trend lies in job creation and income generation. Other interventions, such as education, access and preservation will only enter the equation to complement the underlying ability to save.

Figure 5: Percentage of formal workers contributing towards a pension by income (aged 16 and above)

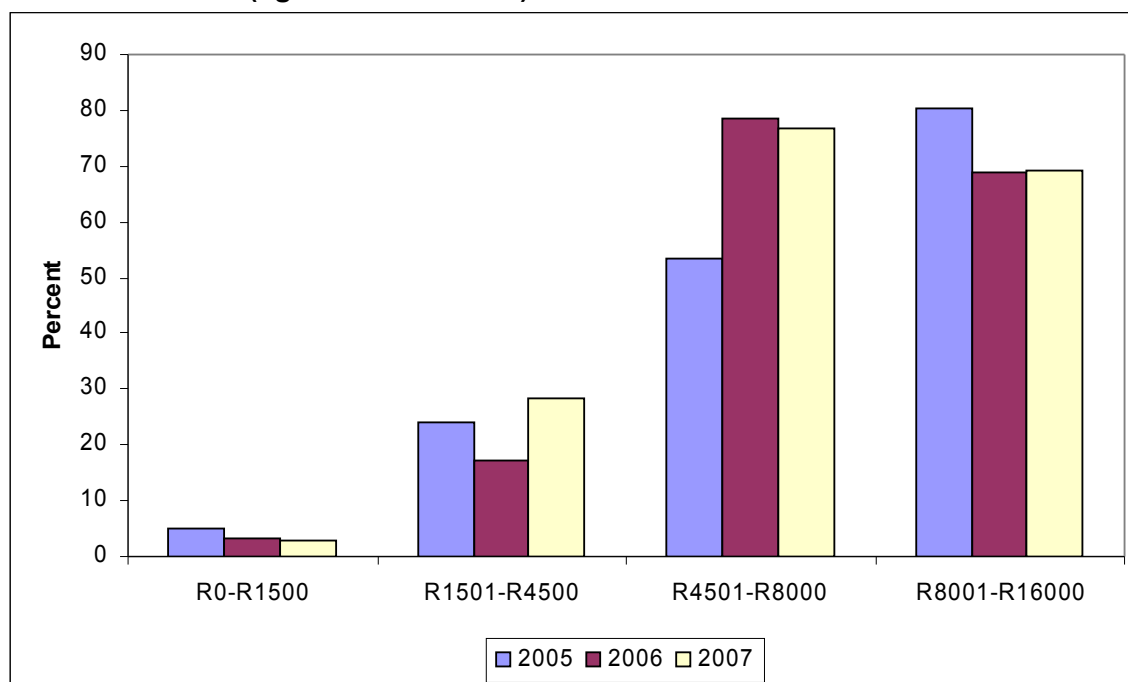


Source: Calculations based on Labour Force Survey

Note: For all values of 10 000 or lower the sample size is too small for reliable estimates

The percentage of informal sector workers contributing towards a pension is shown in Figure 6. Similar to the formal sector, a strong correlation is observed between income and contribution. However, the percentage of those contributing at lower income levels is significantly less in the informal sector. Notably, there has been a substantial increase in the percentage of those contributing towards a pension for those earning between R4, 501 and R8, 000. This has been accompanied by a decline in the percentage of contributors for those earning between R8, 001 and R16, 000.

Figure 6: Percentage of informal workers contributing towards a pension by income (aged 16 and above)



Source: Calculations based on Labour Force Survey

Note: For all values of 10 000 or lower the sample size is too small for reliable estimates

From the above analysis, it has been shown that there is still a sizeable number of workers not providing for their retirement. This applies across the board – both formal and informal as well as low and high income earners. There is no doubt therefore, that the reforms have the potential to mobilise a significant amount of assets. This will be made even more significant if the implementation of the new regime results in observable positive benefits to individuals in the short to medium term, which would in turn result in voluntary savings being generated.

4. SUMMARY

This note has quantified the extent of pension contributions within the formal and informal sector in South Africa over the period 2005 to 2007 (2008). Some evidence on agricultural and domestic workers has also been presented. It has shown that contributing towards a pension is strongly correlated with income in both sectors. Contribution towards a pension is extremely poor among low income workers in the informal sector. At the same time, a notable decline in the proportion of contributors has been registered among low income workers within the formal sector. It has also been observed that retirement provision is also affected by economic cycles as we have observed a further decline in 2008, on the back of the economic slowdown.

The current trend among low income workers is a cause for concern and provides further evidence for the urgency of pension reform. The reform process will need to identify mechanisms of stimulating lower income workers to contribute towards a pension. It is a useful exercise for policymakers to continuously examine international experience on measures used to encourage low income workers to save for retirement.

The number of South African workers with no pension arrangement has increased steadily since 2005. To a large extent this has been a result of growing numbers of formal sector workers that do not contribute towards a pension. This trend strengthens the case for mandatory participation as proposed by the reforms. In addition to increasing awareness through educational campaigns, measures to raise

incomes fundamentally will be required if South Africans are to increase their retirement savings under a mandatory system.