GUEST EDITORIAL
SOME THOUGHTS ON RETIREMENT FUND REFORM

McLeod (2005) warns:
“Actuaries need to remind themselves of their professional responsibility to society at large and not only to the narrow world of private products in South Africa. The issue is also becoming more relevant for retirement-fund actuaries as they begin to deal with the Taylor Committee recommendations1 on mandatory social insurance for retirement.”

Thomson (2005) cautions:
“… organic, holistic thinking is required of the African actuary of the future, thinking that will take seriously the principles of solidarity and reciprocity;” and: “It calls for openness to the challenges of Africa.”

It is in this spirit that I presented a paper (Gluckman, unpublished) to the 2009 convention of the Actuarial Society of South Africa to which the reader is referred for an elaboration of the high-level thoughts put forward in this guest editorial.

Debates on retirement-fund reform have been ongoing within Government circles for years—e.g. the Taylor Commission Report of 2002,2 the National Treasury discussion papers of 2004 and 20073 and the various Department of Social Development papers of 2007. Yet firm decisions and a pragmatic road map forward seem to have escaped us. Why is this?
Possibly the reform debate is too wide-ranging and too complex? No doubt there are many interdependencies between the various components that need to be considered under the broad ambit of social-security reform, including retirement funding, social

1 Taylor Commission Report, Chapter 9 Retirement and Insurance, 2002
2 supra
grants, death benefits, disability benefits, national health insurance and post-retirement medical protection. Then we must add complexities such as the development of a supporting tax policy framework working within the constraints of a finite budget. Could it be that the search for an elusive and unobtainable holistic solution is bound to result in paralysis?

Taleb (2007) warns:

“We produce thirty year projections of social security deficits and oil prices without realizing that we cannot even predict these for next summer—our cumulative prediction errors for political and economic events are so monstrous that every time I look at the empirical record I have to pinch myself to verify that I am not dreaming. What is surprising is not the magnitude of our forecast errors, but our absence of awareness of it.”

I agree with Taleb, and I cannot support policy decisions’ being made on the basis of a 75-year actuarial projection model as put forward in proposals from the Department of Social Development (2007). My paper states:

“Actuarial modelling is important. It helps in setting direction, but in the end it’s just modelling. We must not underestimate the dangers arising from policymakers incorrectly confusing modelling projections and fact, or alternatively significantly underestimating the probability of deviation from best estimates.”

My recommended approach to the problem is a reversion to first-principles reasoning. I start by isolating the problem by focusing on the savings element of the process of retirement-fund reform. I also begin from the current reality, viz. a significant private sector retirement fund industry that is substantial relative to the size of South Africa’s employed population (9.3 million members according to official figures albeit including double-counting) and gross domestic product (industry assets totalled more than 80% of GDP in 2007) operating alongside a universal social old-age grant (currently R1080 a month subject to a means test) that serves as a poverty-relief tool. This is a materially different approach from the more common but erroneous approach of assuming that we start from a clean slate, and thereafter attempting to design a new retirement funding system that works for South Africa.

The cost of transition from the current reality to any new proposed model must be considered at the outset, given that the cost will almost certainly vary substantially depending upon the system design that is chosen. The cost of transition thus becomes an integral part of the decision-making process of choosing any new model.

As reported in my paper, I estimated that the cost of transition in respect of the Department of Social Development’s 2007 proposals could have been in the region of R40 billion to R60 billion for just one element of the total transition cost. I concluded that the costs and risks of transition of the proposed reform model were unacceptably high. More than a year has elapsed since the paper was presented to the Actuarial Society, and as far as I am aware these cost estimates are yet to be disputed, much less refuted (of course this might yet happen). This gives me some confidence that my transition arguments have been accepted.
One can also question how important retirement fund reform is. As stated in my paper: "Whilst it is no doubt desirable that our citizens retire with reasonable financial security and in a position to live their retirement years in relative comfort, this in itself does not make retirement-fund reform a priority issue. There are many competing priorities including education, health, poverty alleviation, housing, job creation, etc."

It seems that it is very difficult to justify prioritising retirement-fund reform over more important competing priorities for the vast majority of the population. Income distribution figures clearly reveal just how skewed a society South Africa is. Furthermore, the South African unemployment rate is exceedingly high relative to similar developing countries, and the stark reality is that the unemployed will be unable to save towards retirement regardless of what new retirement funding model is chosen. In this context, the non-contributory, universal and defined-benefits social old-age grant already provides a reasonable safety net for most relative to pre-retirement income.

McCarthy (2008) questions whether we want to force citizens to save for retirement when this might mean increasing the chances of their not finding jobs, or not being able to afford to purchase their own homes or giving their children a worse education. He argues that, for good reasons, many people, particularly poorer people, choose informal savings channels over formal savings channels.

The needs of the vast majority of the population would be better served by concentrating our efforts on decreasing unemployment rather than imposing a mandatory new retirement funding model that might well pull in the opposite direction by increasing the cost of employment. A sensible approach would be to try to gradually increase in real terms the amount of the social old-age grant—economic growth and reduced unemployment being necessary preconditions for the success of such a policy.

That is not to say that the effectiveness of the existing retirement-fund industry cannot be significantly enhanced for the benefit of members, but this can be achieved without wholesale restructuring. Consolidation of the industry into fewer and bigger funds must bring down costs, as would greater competition supported by an environment of transparency, full disclosure and greater consumer awareness. Product-design simplification and process standardisation will also be necessary to achieve significant savings. Optimal use of the power of defaults could be a relatively quick and easy way to encourage preservation and other desired behaviours. The good news is that market forces already appear to be pushing in the desired direction. My thinking is that the legislative, tax and regulatory environments should simply support these market forces. A lot can be achieved with minimal transition costs and risks.

But the expectation that a few million members within existing retirement funds can somehow cross-subsidise the balance of the population so that all can retire with dignity is unrealistic. As things stand, the average retiree from the system receives an initial pension of less than 30% of final salary. The required level of cross-subsidy is simply too great to work.

This brings us back to the hoary old chestnut of solidarity. Rusconi (2007) writes:
“Most take the view that redistribution is philosophically and morally correct. What separates policymakers is the extent to which redistribution should take place. This is not helped by a poor understanding of how redistribution should be determined and what the options are for increasing or decreasing redistribution.”

It seems that at the macro-level the important issue for our country is the achievement of the appropriate degree of redistribution at an overall societal level within the constraint of increasing the size of economy so that there is more to share. It is much less important what redistribution takes place at the micro-level, e.g. within the retirement-funds system, especially since many proposals in this regard appear flawed (e.g. a contributory defined-benefit component is effectively a regressive tax whereby the poor cross-subsidise the rich). Non-traditional retirement savings policies such as investment in education might well yield greater dividends over the long term.

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REFERENCES


