



Econ3x3

www.econ3x3.org

A web forum for accessible policy-relevant research and expert commentaries on unemployment and employment, income distribution and inclusive growth in South Africa

Downloads from this web forum are for private, non-commercial use only.

Consult the *copyright and media usage guidelines* on www.econ3x3.org

September 2021

What is the size and distribution of the pension contribution gap?

Andrew Donaldson, *University of Cape Town*

Out of 16 million employed people under the age of 65, about seven million contribute to pension or provident funds. Most of those who are not covered earn below the tax threshold, including workers in the informal and agricultural sectors. This first part of a three-part series quantifies the pension coverage gap. The second and third parts will examine the fiscal costs of co-funding universal coverage and how this might be paid for.

The recently published – and subsequently withdrawn – social security green paper proposes a mandatory universal fund, with contributions at a rate of 10-12% up to an earnings level of R276 000. This would pay for a retirement pension and death and disability benefits.

If we are to assess the financial implications and impact of broadening contributory retirement fund membership, we need to know the size of the current gap in coverage. Understanding its distribution assists in thinking through options for targeting and sequencing the expansion of contributory pension funding.

The tax statistics provide reliable indicators of coverage in the top half of the earnings distribution and can be extrapolated to provide reasonable estimates of overall coverage. IRP5 data is collected by SARS from employers for earners above R2000 a year. Taken together with returns submitted by retirement fund administrators, these provide a matched “register” of contributors and taxpayers. Although the published tax statistics cover assessed taxpayers only,¹ the Treasury’s Budget Review provides estimates of the total tax register broken down by earnings group. This allows the more detailed breakdowns of taxpayer numbers by income group in the published tax statistics to be adjusted to generate estimates of pension coverage across the full earnings distribution. In the data summarized below, adjustments have also been made to exclude those over age 65 from the taxpayer numbers.

Based on 2017 tax returns, adjusted for lags in assessment and raised to 2021 prices and the 2021/22 tax brackets, about 90% of taxpayers under the age of 65 with gross incomes above R350 000 are contributors to retirement funds, as are approximately 79% of taxpayers above the personal income tax threshold. The average contribution as a percentage of gross income is 12.1%.

¹ Taxpayers earning a salary from a single employer only, and earning below R350 000, are not required to submit a return for SARS assessment.

Table 1: Estimated numbers of taxpayers and contributors to retirement funds, 2021

Marginal tax rate	Gross income (R'000s)	Registered Taxpayers	Retirement Fund Contributors	Average Contribution/ Gross income	Contributors as % of Taxpayers
0%	0 – 90	3 729 242	1 418 878	11,8%	38,0%
18%	90 – 240	3 017 854	2 061 020	12,1%	68,3%
26%	240 – 350	1 185 133	981 427	13,6%	82,8%
31%	350 – 500	1 050 608	932 856	14,4%	88,8%
36%	500 – 700	761 683	688 009	13,7%	90,3%
39%	700 – 920	307 659	277 039	12,4%	90,0%
41%	920 – 1 975	448 514	399 884	11,5%	89,2%
45%	> 1 975	103 880	87 896	6,8%	84,6%
Total		10 604 573	6 847 010	12,1%	64,6%
Total above tax threshold		6 875 331	5 428 131	12,1%	79,0%

Source: Own estimates, based on SARS Tax Statistics for the 2017 year

This estimate of 6 847 000 pension-fund contributors should be read as a lower bound. There may be contributors who are not on the SARS register. Industry records show considerably higher numbers of clients, though these include duplicate or multiple fund involvement by some individuals.

The tax register does not provide a complete record of employment or earnings – it accounts for about two-thirds of the approximately 16 million recorded as employed in the Quarterly Labour Force Survey in 2016/17. Our estimates of the overall earnings distribution make use of QLFS earnings data for 2018 adjusted to yield aggregate earnings consistent with the national accounts. This adjusted QLFS earnings distribution generates a total number of earners above the tax threshold of just over 7 million, broadly consistent with the tax-data estimates above. The QLFS reported 6.5 million contributors to pension or provident funds in the last quarter of 2016, out of a total of 13.6 million *employees*. For the first quarter of 2021, it reported 6.4 million contributors out of a total of 12.6 million employees – down from 6.6 million in the first quarter of 2020. It is notable that the decline in contributors during 2020 was just 3%, whereas employment fell by nearly 8%. The fund contribution question is not asked of employers or the self-employed, of whom about 780 000 (around 20%) earn above the tax threshold. It seems reasonable to assume that about 400 000 employers or self-employed taxpayers are retirement fund contributors. This would bring the total number of contributors before the impact of Covid-19 to about 7 million – slightly higher than the tax statistics estimate used above.

In Table 2, we blend the tax-based data reported above with QLFS employment and earnings estimates for the first quarter of 2020 (i.e before the loss of employment associated with Covid-19 and economic lockdowns). This provides estimates of the distribution of contributors and non-contributors amongst the total employed in the 15-64 age group.

Table 2: Retirement fund contributors and non-contributors by earnings group²

	Employed	Retirement fund		Non-		Contributors as % of Employed
	2020 Q1	Contributors		contributors		
	('000s)	('000s)	%	('000s)	%	
Earnings (2021 prices)						
R0-45 000	5 406	657	9.4%	4 749	50.6%	12,2%
R45-90 000	3 932	915	13.1%	3 017	32.2%	23,3%
R90-350 000	4 372	3 042	43.5%	1 330	14.2%	69,6%
>R350 000	2 672	2 386	34.1%	287	3.1%	89,3%
Formal (non-agr/hhld)	11 282	6 553	93.6%	4 728	50.4%	58,1%
Informal (non-agr/hhld)	2 921	395	5.6%	2 525	26.9%	13,5%
Agriculture & Household	2 180	51	0.7%	2 129	22.7%	2,4%
Total	16 383	7 000	100%	9 383	100%	42,7%

Source: Own estimates, based on SARS Tax Statistics and QLFS employment estimates.

These estimates show that pension coverage is 16.8% for workers earning below the tax threshold, though nearly a quarter of workers earning between R45 000 and R90 000 a year contribute to a retirement fund.³ Most informal sector workers and employees in agriculture and domestic (household) service are non-contributors. But there are also large numbers of workers in formal employment who do not have retirement fund membership. About 1.5 million individuals with earnings above the tax threshold are not fund contributors. The overall size of the pension coverage shortfall is 9.4 million individuals, or 57.3% of total employment (2020 Q1).

The coverage gap can also be measured as the shortfall in pension contributions *by value*.

Estimates are provided of this in Table 3, calculated as a minimum contribution requirement of 10% of the earnings of non-contributors. The pension contribution coverage gap, measured in this way, is R69 billion, or 18.4% of the sum of current contributions and this contribution gap. South Africa has high rates of participation of earners in the top half of the earnings distribution in occupational or voluntary retirement fund plans. This reflects the effect of tax deductibility in encouraging fund membership, and the effect of bargaining council or employer-provided pension fund rules that mandate participation by employees. However many contributors withdraw their savings before retirement, on termination or changes in employment, and may as a result reach retirement age without an adequate level of accumulated savings.

For this reason, *mandatory preservation* is widely seen as a desirable goal of retirement policy, linked to the continuation of tax-privileged contributions.

But this cannot realistically be achieved without a substantial enhancement of income support for the unemployed, and without fiscal assistance for retirement fund membership below the tax threshold.

² QLFS employment in 2020 Q1, with earnings distributions from the 2018 dataset adjusted to align with national accounts estimates of gross earnings and raised to 2021 prices.

³ R45 000 a year is approximately the annual value of the 2021 national minimum wage of R21.69 an hour.

Table 3: The retirement contribution funding gap

	Retirement fund Contributors			Non-contributors	
	Earnings (R billion)	Contributions (R billion)	Contribution rate	Earnings (R billion)	Contribution gap at 10% rate (R billion)
Earnings (2021 prices)					
R0-45,000	15.9	2.4	15.3%	111.4	11.1
R45-90,000	66.2	7.2	10.9%	180.0	18.0
R90-350,000	627.4	80.1	12.8%	188.9	18.9
>R350,000	1 821.9	216.5	11.9%	208.2	20.8
Formal (non-agr/hhld)	2 351.9	284.6	12.1%	437.4	43.7
Informal (non-agr/hhld)	165.8	20.1	12.1%	145.1	14.5
Agriculture & Househld	13.6	1.7	12.1%	106.1	10.6
Total	2 531.4	306.3	12.1%	688.5	68.8

Source: Own estimates, based on SARS Tax Statistics and QLFS employment estimates.