TIPS

POLICY BRIEF: 1/2016

Using the UIF surplus as part of a stimulus package

RECOMMENDATION

The commodity boom and the drought confront South Africa with difficult challenges that require innovative responses. In these circumstances, this briefing note assesses proposals for using the Unemployment Insurance Fund's current and accumulated surpluses – currently worth over R100 billion – to support economic growth without impacting on the sustainability of the fund. It concludes that the benefits strongly outweigh the risks, especially for workers and the unemployed.

Trade & Industrial Policy Strategies (TIPS) is a research organisation that facilitates policy development and dialogue across three focus areas: trade and industrial policy, inequality and economic inclusion, and sustainable growth

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THE NEED FOR A STIMULUS PACKAGE

The end of the commodity boom from 2011 has placed the South African economy under real pressure. From 2011 through late 2015, the prices of South Africa's top exports – platinum, iron ore, coal and gold – dropped by a weighted average of around 50%. Export revenues fell more than 15% in US dollar terms from 2011 to 2014.

Mainly as a result of these factors, the growth rate has declined substantially in the past four years. The International Monetary Fund (IMF) projects a further slowdown to 1,3% in 2016 – just over a third of the average rate of growth during the commodity boom from 2001 to 2011 (1). Although employment creation has remained comparatively strong, it seems likely to slow or even turn to job losses as economic growth slides, especially given reduced growth in government spending.

The main risk to the economy is stagflation, due to a combination of:

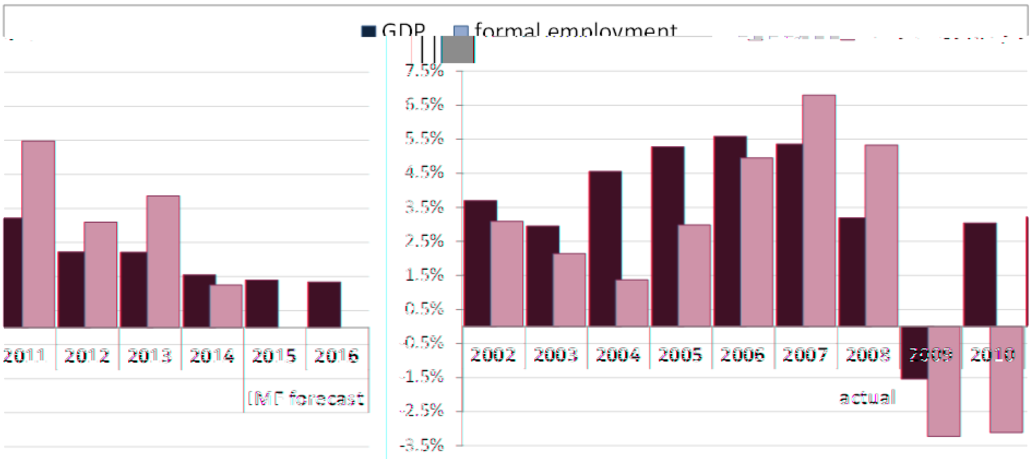
- Rapid depreciation resulting from reduced short-term capital inflows and lower export revenues, and
- Stagnant domestic demand as a consequence of the slowdown in mining, with limited scope for export growth at least to China, Japan and Europe.

In these circumstances, depreciation can generate inflation without substantially stimulating demand for increased production. This situation would likely slow job creation and reinforce income inequalities, which turn would cause substantial social and political strains.

Normally, the state should respond to slower growth with a counter-cyclical stimulus based on increased spending and lower interest rates, in order:

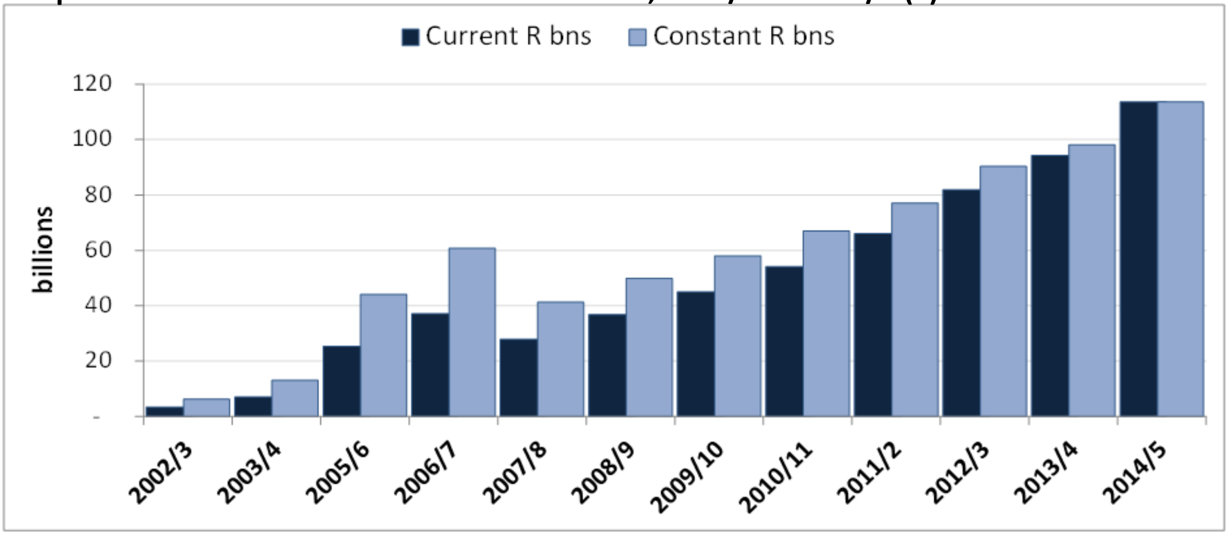
- To increase domestic demand, investment and employment, and
- To promote investments and public spending on programmes that generate jobs and help diversify the economy, taking advantage of the more competitive exchange rate.

Graph 1. Annual percentage growth in the GDP and employment, 2001 to 2015



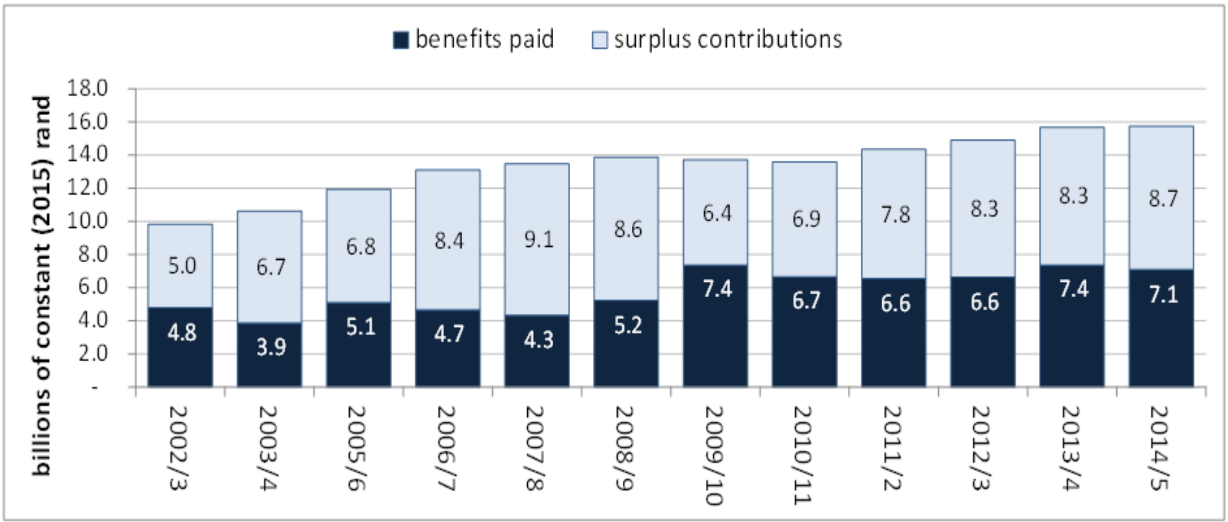
Source: Statistics South Africa, GDP and Statistics South Africa, Quarterly Labour Force Survey, relevant years

Graph 2. UIF assets in constant and current rand, 2002/3 to 2014/5 (a)



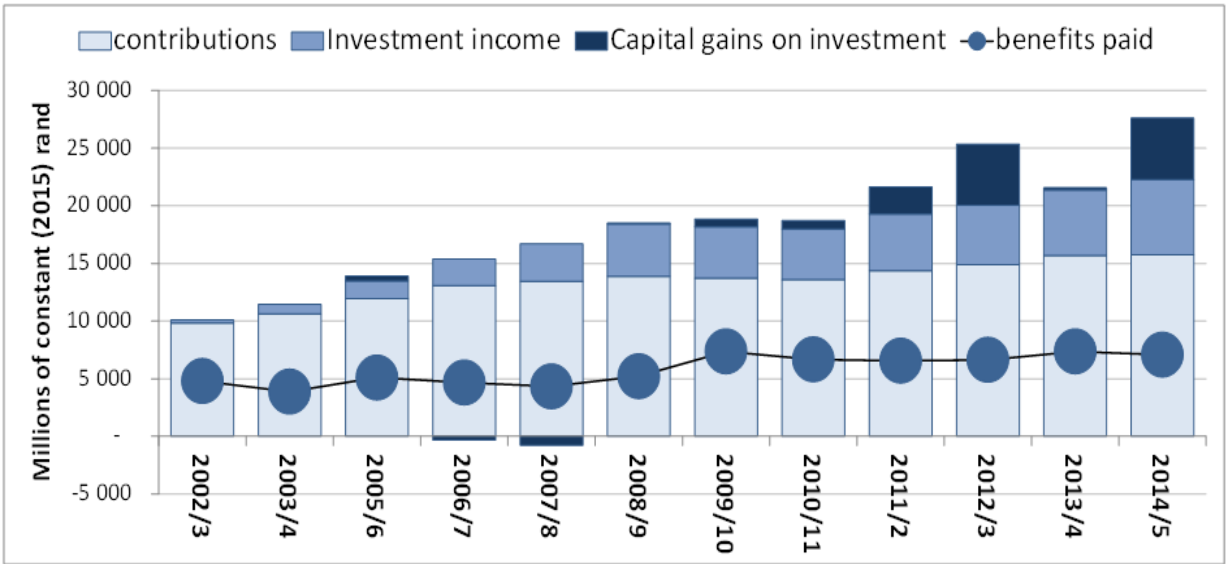
Note: (a) Deflated using CPI. The UIF Annual Report for 2004/5 is not available on the Department of Labour website. Source: UIF Annual Reports, financial statements, for relevant years.

Graph 3. Benefits and contributions, 2002/3 to 2014/5 (a)



Note: (a) The UIF Annual Report for 2004/5 is not available on the Department of Labour website. Source: UIF Annual Reports, financial statements, for relevant years.

Graph 4. UIF income by source compared to benefit payments, 2002/3 to 2014/5 (a)



Note: (a) The UIF Annual Report for 2004/5 is not available on the Department of Labour website. Source: UIF Annual Reports, financial statements, for relevant years.

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- To increase domestic demand, investment and employment, and
- To promote investments and public spending on programmes that generate jobs and help diversify the economy, taking advantage of the more competitive exchange rate.

It has become increasingly difficult to maintain a conventional counter-cyclical stance, however. In response to the unusually deep 2008/9 global financial crisis, the budget went into deficit and interest rates were reduced.

- In 2007/8, the budget had a surplus equal to 1% of the GDP; in 2009/10, it dropped to a 6% deficit, which was projected to decline to 4,1% in 2015/6.
- Interest rates fell from a high of 12% in June 2008 to a low 5% in July 2012. Since then, the Reserve Bank has raised its interest rate to 6.75% in a bid to control inflation despite slowing growth.

The implications of shifting toward a more contractionary stance can be seen from the trends in public spending and employment in the past few years. From 2008 to 2014, government spending expanded an average of 3,5% a year in real terms, although the rate declined over the period. In these years, public sector employment, mostly in health, education, security and local government services, grew a total of 24%, compared to net growth of 3% in formal private jobs outside of agriculture.*

The challenge in these circumstances is to identify innovative measures that achieve the aims of a more conventional stimulus package. This paper reviews one such possibility, which is to use the UIF surpluses, valued at over R100 billion, and which increased by 11% a year in real terms from 2005 to 2015.

This briefing note assesses the costs, benefits and risks of using these resources as part of a stimulus package through a combination of:

- A three-year holiday on contributions, which would reduce production costs and raise take-home pay for formal employees earning under R15 000 a month, and
- Increased investment of accumulated UIF surplus in programmes that create jobs and/or promote collective action at community level to take advantage of economic opportunities.

The next section indicates the extent and causes of the surpluses at the UIF, followed by a description of current efforts by the UIF itself to use them. The final part applies the socio-economic impact assessment system (SEIAS) methodology to assess the potential benefits, costs and risks of the proposed inclusion of these resources in a stimulus package.

EXTENT AND CAUSES OF UIF SUPPLUS

As Graph 2 (page 2) shows, in constant 2015 rand,** the UIF's total assets climbed fairly steadily at 16% a year, rising from R41 billion in 2005/6 to R114 billion in 2014/5. In nominal terms, its assets increased from R28 billion to R114 billion.

For comparison, in the same period the GDP grew by 2,4%, employment by 1,2%, unemployment by 3,4% and government spending (in real terms) by 4,6% annually. The UIF’s contributions from workers and employers increased by 2% a year. Its payouts, which benefit around 750 000 workers annually, climbed by 7% annually.

The extraordinary growth in UIF assets reflects a fundamental shift in the structure of the UIF's income in the past decade. Because benefit payments equalled an average of just 43% of contributions throughout this period, the UIF built up a substantial surplus. That in turn led to increased investment income every year. Since it did not need the investment income for benefits, these sums also went into its assets, in turn generating more income. The result was that the UIF’s asset growth snowballed.

As Graph 3 (page 2) shows, from the early 2000s contributions have exceeded payouts by more than 100% except in 2009/10. In that year, which saw the loss of around a million jobs due to the global financial crisis, contributions still exceeded benefits by 86%. The result was that the UIF obtained an annual surplus of contributions over benefits equal to between R6 billion and R9 billion in 2015 rand.

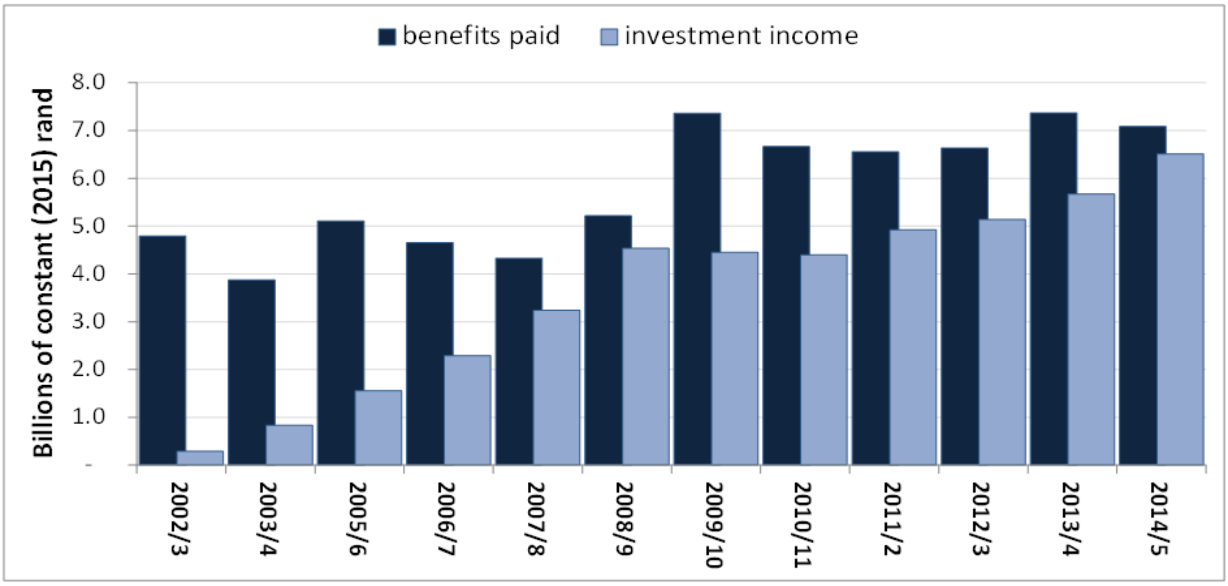
The resulting annual surplus has been invested primarily in government bonds, although equity has seen a rising share. Income from these investments rose from 3% of the UIF's total revenue in 2002/3 to 25% in 2008/9, and has remained around that level since then.

The UIF’s investment income was not required to pay for benefits, which were still more than covered by contributions (Graph 4, page 2). As a result, it was reinvested annually, increasing the UIF's total assets and leading in turn to renewed growth in investment income.

**Expenditure data from National Treasury, Budget Review, 2014/5, Annexure G, data in excel format, downloaded from www.treasury.gov.za. Figures for total expenditure, deflated using GDP deflator calculated from Statistics South Africa, GDP data for the third quarter 2015, data in excel spreadsheet, downloaded from www.statssa.gov.za. Series on GDP in constant and current rand. Employment data are calculated from Statistics South Africa, Labour Market Dynamics for 2010 and 2014, electronic databases downloaded from www.statssa.gov.za. Series on employment status and type of employer.*

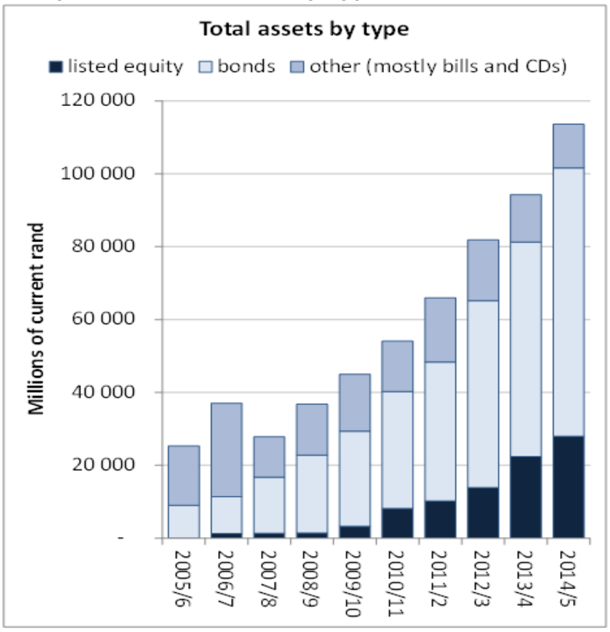
*** Throughout this document, current figures are deflated using the Consumer Price Index (CPI) rebased to March 2015.*

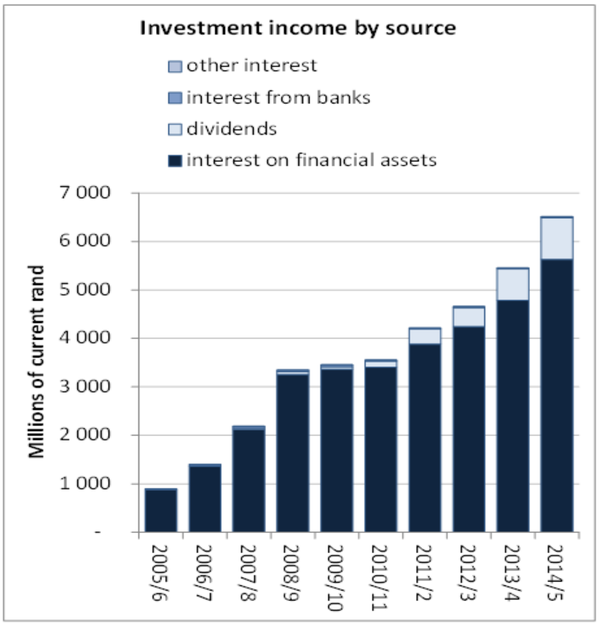
Graph 5. Benefits as a percentage of investment income



Note: (a) The UIF Annual Report for 2004/5 is not available on the Department of Labour website. Source: UIF Annual Reports, financial statements, for relevant years.

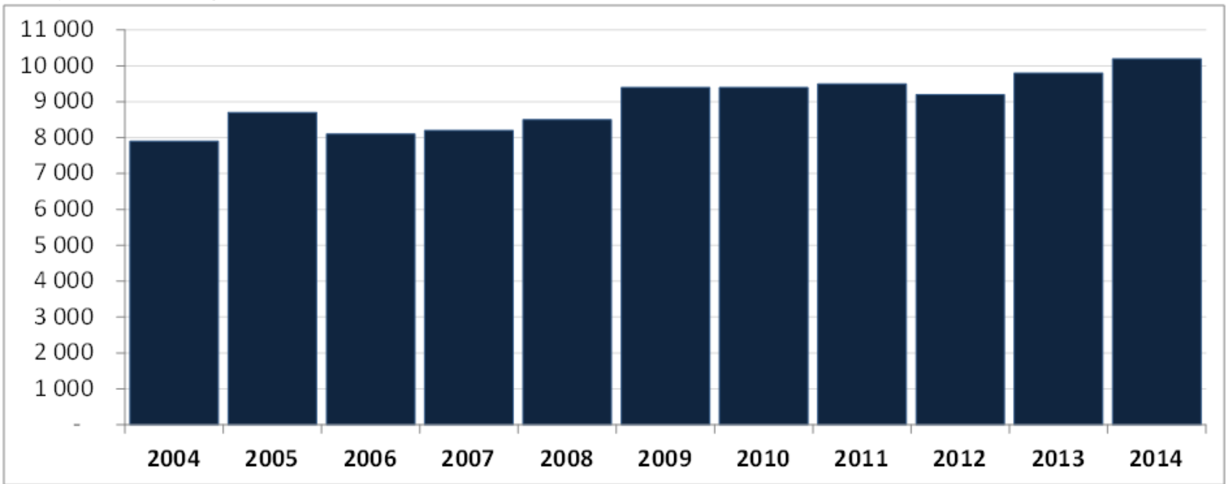
Graph 6. Investment by type and investment income by source, 2005/6 to 2014/5





Note: (a) The UIF Annual Report for 2004/5 is not available on the Department of Labour website. Source: UIF Annual Reports, financial statements, for relevant years.

Graph 7. Average UIF benefits in constant 2015 rand (a)



Notes: (a) Deflated with CPI. The UIF Annual Report for 2004/5 is not available on the Department of Labour website. Source: UIF Annual Report 2014/5.

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From 2008/9 through 2014/5, the UIF's investment income alone climbed from 6% of benefits paid to almost 100% (see Graph 5, page 4). From 2008, the UIF could cover over three quarters of benefits payments from its investment income, without requiring contributions at all.

To illustrate the implications of the growth in UIF investment income, consider a worst-case scenario. Suppose that, as a result of the end of the commodity boom and the global economic slowdown, UIF benefit payments climbed by 48%, as much as they did during the global financial crisis in 2008/9. That would entail an increase of R3,4 billion in 2014 terms. Even in this extraordinary scenario, the UIF could still meet its obligations without dipping into its capital. Indeed, it could meet them even if contributions were cut by three quarters.

The bulk of the UIF's investment income comes from returns on bonds, not from equity (Graph 6, page 4) Moreover, the increase in its assets occurred during a period of relatively low interest rates by South African standards. In other words, it is unlikely to be significantly affected by lower equity prices or interest rates.

The excess of contributions over benefits did not occur because of undue restrictions on the growth in benefits. In fact, in real terms average benefits increased significantly. As Graph 7 (page 4) shows, in 2015 rand, unemployment benefits rose from an average of R7 500 in 2004/5 to R10 100 in 2014, or by 29%.

In 2015, the National Treasury argued for a reduction in UIF contributions to stimulate the economy and reduce the burden on workers. UIF officials and board members responded that this measure should not be introduced because new amendments to the UIF Act would increase the cost of benefits.

The argument that the UIF needs its resources to meet the requirements of the proposed UIF Act amendments is problematic for two reasons.

- Economic analysis suggests that the amendments, taken as a whole, will probably not impose substantial additional costs, contrary to the UIF’s own projections, and
- Even if benefit payments increased to equal contributions, the UIF’s assets would continue to grow due to its investment income.

** Data on public service employment calculated from Labour Market Dynamics 2014, electronic database downloaded from www.statssa.gov.za in January 2016, series on type of employer, main work, age, employee earnings and education status. The figure for public servants earning under the UIF ceiling excludes government employees earning under R3 000 a month, which approximates the minimum in the public service proper, excluding local government.*

The proposed amendments would enhance benefits to workers, in part to absorb the excess of contributions over payouts as an alternative to reducing contributions. Benefits would be improved through amendments that:

- Increase the maximum number of benefit days accrued from 238 to 365, with improved benefits for illness,
- Change procedures to make it easier for workers to apply, enabling them to benefit more frequently, and
- Empower the Minister to vary benefits and the benefit period by regulation rather than through formal amendments to the Act.

But the new amendments also extend the UIF to public servants. Since public servants are virtually never retrenched, this will result in a significant increase in contributions without equivalent growth in payouts. Public servants make up around 10% of total formal employment,* so contributions would increase by at least 10%, equal to R2,3 billion in 2014. That would cover a 30% increase in total benefit payments.

Furthermore, around half of public servants earned more than the ceiling in 2014, compared to about 15% of private employees. Public servants get higher salaries mostly because the majority are professionals – close to half have a tertiary degree, compared to about one worker in seven in the private sector. Moreover, pay for lower-level workers is higher in the public sector than in the private sector. As a result, contributions are likely to increase by significantly more than 10%, without any concomitant growth in benefit payments.

Overall, the amendments as currently proposed will raise the contribution of workers and the state to the UIF surplus, further reducing the stimulus effects of state spending. The proposed increase in benefits seems unlikely to exceed this increase in income, unless the Minister significantly improves benefits based on the proposed new powers. At the same time, the amendments do little to ensure that the UIF's substantial resources are used more actively to limit the effects of the commodity bust and the drought and to support job creation on a large scale.

In effect, the UIF’s ability to accumulate such a large surplus reflects its position as a statutory monopoly with a mandatory contribution. In the private sector, the premiums earned by private insurers equalled 65% of net claims paid in 2014. Commissions absorbed a further 13% of premiums, leaving a surplus for the year of just over 20% compared to the UIF’s surplus of well over 50% that year. It seems unlikely that, if the UIF had competition, it could continue to charge such a high rate compared to the benefits paid.

Table 1: Socio-economic costs, benefits and risks per stakeholder

	Workers	Employers	Unemployed	The state
Benefits	Reduction in contributions from wages equal to 1% of income up to almost R15 000. Total benefit: around R4,5 billion, or around R500 per registered employee. Higher take-home pay provides some protection against rising food prices due to drought. Economic stimulus and increased resourcing of economic programmes helps protect employment and incomes against impact of commodity bust. The stimulus effect would be equivalent to around a 5% reduction in taxes. The cost of labour is reduced relative to capital, and producers become more competitive, which would also promote jobs.	Reduction in contributions on payroll equal to 1% of income up to almost R15 000. Total savings: around R4,5 billion. Increased demand for consumer goods and services as workers' take-home pay improves helps offset reduced demand as a result of commodity bust. Increased support from the state for diversification and growth provides some cushion against commodity bust.	Increased funding of state programmes to restructure the economy and generate jobs, including through public employment schemes. R15 billion a year is equal to 11% of current spending by the economics departments, and is around three times the value of current dti transfers to support diversification and business development.	Able to sustain key programmes to protect the poor and drive economic growth despite the downturn. R15 billion a year is equal to around 1,2% of current spending.
Costs	Savings from previous contributions would be used to promote job creation rather than improve benefits for the retrenched. State agencies would have increased control over past savings from contributions, rather than the (trilateral) UIF board.	After five years, employers (including the state) would have to negotiate the reintroduction of contributions and accept reinstatement of payroll deductions.	Improvements to UIF benefits would be constrained, since they would have to be paid for out of the accumulated surplus. An average of 735 000 people have benefited from the UIF annually in the past five years, ranging from 706 000 in 2011 to 763 000 in 2013. That is equal to about two thirds of those who lost their jobs and 13% of the total unemployed (that is, people who have actively sought work in the week before the survey).	The UIF holds at least 3,5% and possibly up to 6,5% of domestic bonds issued by all spheres and agencies of the state. If it sold only bonds to transfer resources to more active uses, the sales would equal around 0,1% of total government marketable domestic debt annually, or a total of 0,5% over five years.
Risks	The state does not use the resources in ways that stimulate the economy and generate employment, so the UIF's loss of resources does not bring anticipated benefits.	Same as for workers.	Same as for workers.	Same as for workers. If the downturn persisted beyond five years, programmes funded by the UIF would face real cuts.

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In sum, the UIF's large and growing asset base resulted originally from the persistent surplus of contributions over benefits. The resulting increase in investment income, which is entirely reinvested, has created a snowball effect. In these circumstances, the UIF's asset base will keep growing even if benefits and contributions are brought into balance. In effect, the UIF has become a forced saving scheme for workers and employers at a time when the economy needs to increase, not decrease, aggregate demand.

UIF EFFORTS TO USE THE SURPLUS

The UIF has made some effort to use its resources to support job creation. These efforts have, however, been limited in size, affecting less than 5% of its total investments and reaching only a few thousand people every year. Neither the UIF nor the Public Investment Corporation, which manages its assets, has the expertise or capacity to use the UIF's assets for developmental ends. In any case, it seems undesirable for the UIF to act as an employment agency without being integrated into broader state policy processes, especially given the size of the resources involved.

To date, according to its documentation, the UIF's funding for job creation and poverty alleviation has gone for the following:

- Training schemes for unemployed people, in association with Sector Education training Authorities (SETAs), with the target of reaching 8 000 by 2017/8, up from 5 000 in 2014/5. In 2014/5, it spent around R80 million on these programmes, or around 0,08% of its assets.
- The training lay-off scheme, under which workers agree to exchange their wages for a stipend while being trained in order to keep their jobs when their employers would otherwise retrench them. As of 2014/5, the UIF had spent just over R100 million on this scheme (that is, around 0,1% of its assets).
- The UIF has lent R2,8 billion to the Industrial Development Corporation (IDC) for lending to projects that will generate employment, equal to about 2,5% of its assets.
- The UIF is establishing additional facilities to assist retrenched people in seeking employment and with training, essentially bolstering active labour-market policies. These processes are still in the planning stage.
- It has begun to support "aspiring entrepreneurs", apparently mostly through training, targeting 600 individuals a year by 2017/8.

Except for the IDC bond and the training lay-off scheme, these programmes are not directly integrated with national initiatives around job creation, industrial policy, training or support for emerging enterprise. This may explain why the UIF has encountered difficulties in rolling them out. In 2014/5, for instance, according to its Annual Report it budgeted R550 million (0,5% of its assets) for schemes to alleviate unemployment, but actually spent only R93 million (0,1%).

Arguably, because the bulk of the UIF's investment goes to government bonds, it automatically contributes to development by holding down the cost of public-sector borrowing. In 2014/5, the UIF reported holding 52% of its assets in government and parastatal bonds, or R60 billion; some of these holdings might have been in foreign debt. It held a further R50 billion in inflation-linked bonds, although it did not specify if they were public or private. In that year, the Reserve Bank reported that the public sector as a whole, including all spheres of the state and its agencies, had domestic marketable debt worth around R1,6 trillion. The UIF's holdings of government and parastatal stock consequently accounted for about 3,6% of the total. If all of the inflation-linked bonds were state owned, its holdings of government stock would increase to around 6,5% of the total.

SOCIO-ECONOMIC COSTS, RISKS AND BENEFITS

This section provides a brief assessment of the socio-economic costs, benefits and risks of proposals to use UIF resources as part of a stimulus package. The specific proposals assessed are:

- A three-year contributions holiday, with payouts covered by investment income plus R1 billion from accumulated surpluses; and
- Over five years, reduction in the UIF surplus to R30 billion, with the transfer of around R15 billion a year to government programmes and industrial financing institutions for investment to diversify and grow the economy over this period. We do not explore mechanisms for effecting this transfer, which could affect the impact.

The methodology used here draws on the socio-economic impact assessment system (SEIAS) approach adopted by Cabinet for regulatory assessment, in that:

- It assesses the implications for different social groups, specifically workers, employers, the unemployed and the state;
- It reviews the risks attendant on the proposals; and
- It provides a qualitative evaluation where the data do not permit a quantitative analysis.

Table 1 (page 6) provides a matrix with the detailed findings from this exercise. They can be summarised as follows.

For context, in 2015 there were around 11 million formal sector workers and 1,3 million domestic workers, most of whom are liable for UIF contributions. In addition, there were 5,4 million unemployed people – that is, individuals who were actively looking for paid employment. Of these, around a million had lost their jobs in the previous year; most of the rest had never been employed or had left their work for another reason for more than a year earlier. From 2008 to 2014, an average of 735 people received some form of UIF benefit, mostly because they were retrenched.

THREE YEAR CONTRIBUTIONS HOLIDAY

Benefits

- An effective increase in workers' and employers' incomes by R9,5 billion a year (split equally at 1% each for employers and workers on earnings up to around R15 000 a month). That would both stimulate demand, especially for mass-produced consumer goods, and provide some protection against the higher food prices anticipated as a result of the current drought. The effect would be progressive at least within the formal and domestic sector, since UIF takes a larger share of the income of workers earning under R15 000 a month.
- A stimulus to the economy and job creation by increasing demand, especially for wage goods, and reducing production costs (and specifically lowering the cost of labour compared to other inputs). Wage goods are more likely to be locally produced than luxuries, which would increase the multiplier effect of the measure compared to less progressive interventions.
- If the proposed amendments including public servants were enacted in 2016, the measure would save the state at all levels around R2 billion a year in UIF contributions, which could be redirected to developmental programmes in the economy and society.

Costs

- Benefits for retrenched workers could not be significantly improved over this period unless the UIF was prepared to use part of its accumulated surpluses. This would be an opportunity cost for new beneficiaries (around 700 000 people a year), since they would effectively forego improvements in payments beyond those foreseen in the 2015 amendments.
- Employers, including the public sector, would have to reintroduce contributions after three years, which would require both care in wage negotiations and impose some administrative costs.

Risks

- For workers, and especially those in vulnerable jobs such as domestic workers, the main risk is that employers would not reintroduce UIF contributions on the same scale three years from now.
- For both workers and employers, the risk would be that the slowdown leads to a substantial increase in retrenchments and payouts, which in turn would mean the UIF would have to eat into its investments more than anticipated in the proposal.

USING THE ACCUMULATED UIF SURPLUS FOR ECONOMIC PROGRAMMES AND EMPLOYMENT SCHEMES

Benefits

- For workers, the unemployed and employers, the core benefit would be increased job opportunities and incomes, as well as improved government services. The proposed use of R15 billion a year for state programmes would enable the state to increase spending on economic programmes by more than 10%.
- The expenditure would also help stimulate the economy, effectively increasing aggregate demand by R15 billion a year. It would equate to an increase in state spending of around 1,2%. The impact on growth would depend on the multiplier of this spending, which in turn would result from the nature of programmes funded and the extent of import leakage in state spending.

Costs

- As noted, the UIF holds at least 3,5% of government bonds. Shifting from these assets to current expenditure would have some impact on the cost of state debt. In the event, if the UIF financed the transfer entirely by selling state bonds, it would affect 0,1% of total state marketable domestic debt annually, or 0,5% over the full period proposed.
- Resources now managed by the tripartite UIF board would instead be controlled by the state, reducing the power of some stakeholder representatives over significant amounts of money.

Risks

- For all stakeholders, the main risk is that the state would not use the resources effectively. While there would then still be a stimulus from higher state expenditure, the hoped-for diversification of the economy and large-scale job creation might not be achieved.
- For the state, after five years it would no longer have access to resources from the UIF. If the economic slowdown persists for more than five years and/or National Treasury does not plan for the transition, this could cause cuts in funded programmes when the programme terminates.