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P A P E R S

Social Assistance Grants, Poverty
and Economic Growth
in South Africa

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Work in Progress. Comments Welcome.

1 Introduction

Three major aspects play a part in discussions on social security: efficiency, equity and administrative feasibility. This paper focuses largely on the equity issue. The first part of the paper uses a microsimulation model to look at the economic incidence of social assistance grants and draws some conclusions about the redistributive effects of social assistance grants in South Africa. The second part of the paper considers some of the complex relationships between social security, economic welfare and economic growth at the macroeconomic level. This discussion is inconclusive as there is no consensus on the question whether a social security constitutes an impediment for economic performance or whether it, on the contrary, enhances economic activity. Both sides of the argument are presented. On the one hand, it is argued that a reduction in poverty and inequality may provide a favourable “initial condition” for rapid and sustainable growth. Furthermore, social security serves an “irrigation function” whereby the existence of a social security system fosters economic growth by providing the unemployed with the opportunity to search for good and productive job matches which in turn enhances growth. On the other hand, the financing of the grants system reduces savings which may dampen growth.

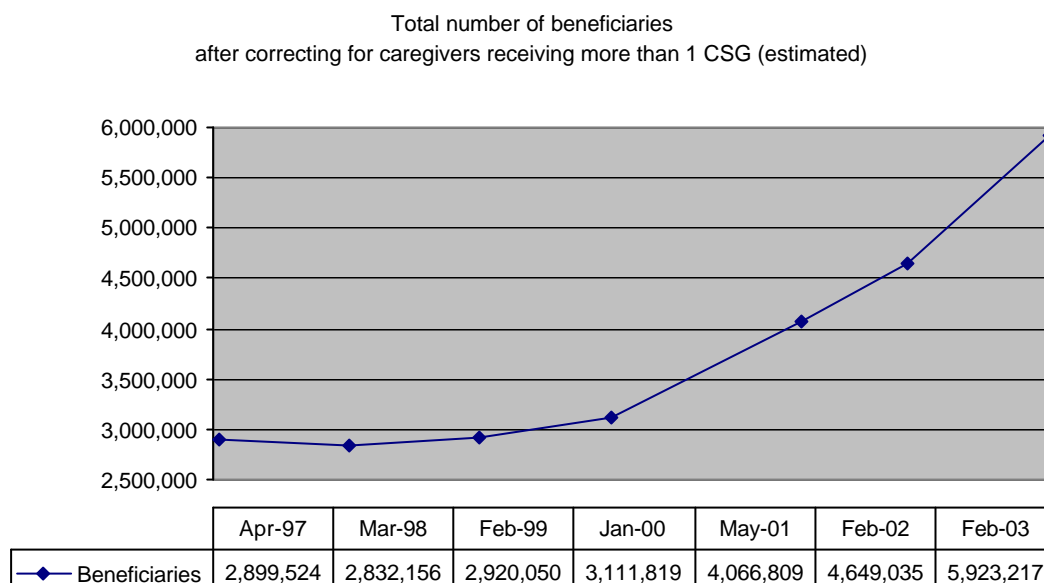
In the 20th century two concepts of social security have emerged, the insurance concept and the redistribution concept (den Butter & Kock, 2001). The insurance-concept focuses on insuring workers against the risk of income loss and hence it increases lifetime income smoothening. Most programmes based on this concept are financed out of premiums and contributions and benefits depend on earnings. “Redistribution” programmes, on the other hand, do not focus on workers alone and the key element is poverty relief. Benefits are financed out of general tax revenues and hence there is no link between contributions and benefits. While South Africa has both types of systems, only social assistance grants (which would classify as a redistribution programme) are considered here.

2 Social Assistance Grants in South Africa

Social assistance refers to non-contributory and income-tested benefits provided by the state to vulnerable groups unable to provide for their own minimum needs, such as the disabled, the elderly and young children in poor households. Almost 6 million South Africans receive social assistance grants each month¹ and this number is

¹ In February 2003, 4 870 959 recipients received benefits totalling R2 250 865 689 (SOCPENS). The average size of the CSG paid out was, however, R216.70 which means that the average recipient of the

steadily rising as a result of the extension of the Child Support Grant and increased public awareness of eligibility for grants.



Source: author's adjustments of SOCPEN data, Dept of Social Development

This paper focuses on the three child grants (Child Support, Foster Care and Care Dependency), the Old Age Pension and the Disability Grant. These grants accounted for 99,8% of the total value of social assistance grants in February 2003.

The data used in this paper comes from two sources, *viz.* microsimulations based on the national household surveys of Stats SA and the SOCPEN system of the Department of Social Development.

2.1 Social Old Age Pensions

The Old Age Pension is a means-tested benefit with eligibility based on age, level of income and citizenship. The maximum monthly amount is currently R700. Single persons with income above R1410 per month are not eligible for the grant and married persons with a combined income above R2610 per month are not eligible for the grant.²

CSG was in fact collecting the grant in respect of an average of 1.35 children. If we count the *child* as the recipient and not the caregiver, this means that an estimated 5 923 217 people were receiving grants.

² The size of the grant for an unmarried person is calculated according to the formula $D = 1,15A - 0,5B$ and for a married person, according to the formula $D = 1,075A - 0,5B$

Where **A** = the maximum grant payable per annum as approved

B = the annual income of the applicant in the case of an unmarried person, or half the applicant and his or her spouse's annual income in the case of a married person and

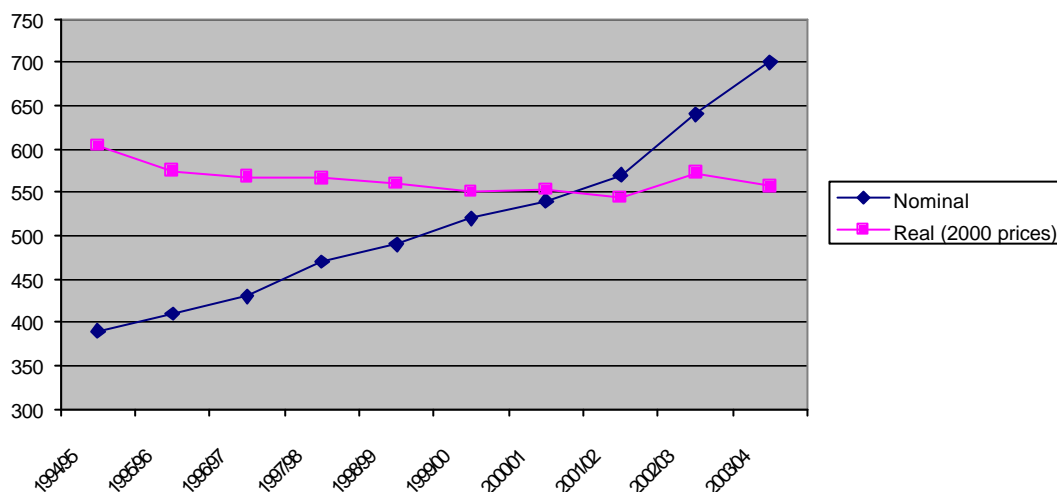
D = annual grant amount payable

No grant amounting to less than R100 per month is payable

At more than twice the median per capita income for Africans³, the level of the state old age pension (SOAP) is generous by international standards. Furthermore, the Smith Committee found that the level of the social old age pension when expressed as a percentage of GNP per capita compares favourably internationally (Smith Committee, 1995).

The graph below shows that the level of the Old Age Pension has declined slightly in real terms since 1994. In the early 1990s the level of OAP had grown very rapidly for most pensioners as a result of equalisation across race groups. Figure A1 in the Appendix shows the growth in the size of the OAP for each race group from 1965 to 1993. Take-up has increased since 1994, meaning that the grant has become more costly over time. In addition, the introduction and growth of child grants has limited fiscal capacity to increase pensions.

Figure 1: Level of Old Age Pension



2.2 Disability Grants

The state provides disability grants to the disabled (including the blind) from age 18 to retirement age, subject to medical eligibility criteria and the same means-test as for the SOAP.

In 1993, disability grants (DG) went to 13 out of every thousand South Africans, but there were clear racial discrepancies (van der Berg, 2001). Whereas the DG went to 8 per 1000 Whites and 12 per 1000 Africans, it went to 31 per 1000 Coloureds and 23 per 1000 Asians (ibid.). The statistics are no longer collected by race group, but the provincial distributions indicate that the eligibility criteria are not being consistently applied. Table 2 shows that adults are more likely to be accessing the DG in the Northern, Eastern and Western Cape than in any of the other provinces.

³ The 2000 IES found that the median per capita income for Africans was R218 per month. This equates to R276 per month in 2003 prices.

Table 1: Incidence of Disability Grants as at February 2003

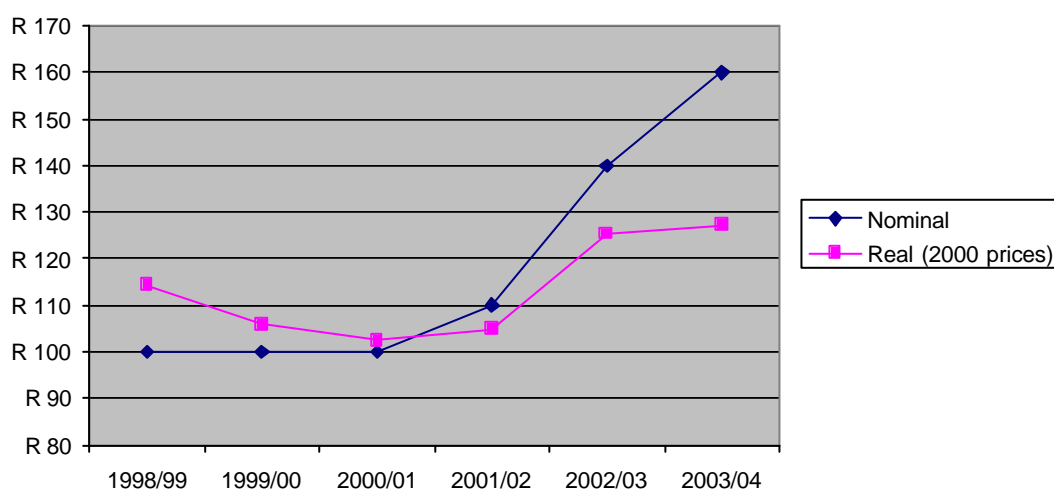
	Number of adults	Number of people receiving Disability Grants as at February 2003	Number of disability grants per thousand adults
EC	4,159,114	191,212	46
FS	1,876,269	67,909	36
GP	5,650,469	103,968	18
KZN	5,680,841	143,115	25
LP	3,164,545	71,191	22
MP	1,889,939	43,299	23
NW	2,274,340	63,771	28
NC	577,727	33,140	57
WC	2,911,617	106,187	36
ALL	28,184,861	823,792	29

2.3 Social Security Provisions for Children

On the recommendation of the Lund Committee the *Child Support Grant* (CSG) was introduced in 1997. The grant is means-tested on the basis of the income of the primary care-giver and her/his spouse. Initially, only children under the age of 7 qualified for the grant, but in the current fiscal year coverage has been extended to children under the age of 9 and by 2005 all children in need under the age of 14 will be included.

The number of beneficiaries has been rising rapidly. In 1999/00, there were 321 906 beneficiaries – by October 2003, this number had risen to 2 116 325. Uptake remains low, however: estimates of the number of children under 7 who should be entitled to the grant vary from 4 to 5 million.

Figure 2: Level of Child Support Grant



The *Foster Care Grant* is payable to a foster parent in respect of a foster child who has been legally placed in her/his custody in terms of the Child Care Act. The level of the Foster Care Grant is currently R500 per month. The number of grants paid per month has increased from 45 000 in April 1999 to almost 82 000 in February 2003.

This number possibly reflects low take-up, however, given that 20% of children are not residing with either of their parents (Taylor, 2002). To qualify for a Foster Care Grant (FCG), the child must be placed in the care of foster parents through the children's court. The court process is lengthy and complex, making this grant relatively difficult to access. Notably, children living in child-headed households are unable to access the FCG even if they are orphans.

A *Care Dependency Grant* is payable to the caregiver of a child that is in need of full-time care as a result of a severe mental or physical disability. This grant is means-tested on the basis of the income of the child which must not exceed R48 000 per annum. The number of grants paid per month has increased from 17 000 in April 1999 to more than 42 000 in February 2003.

2.4 Targeting

Table 2 shows the percentage of total income that comes from social assistance grants across the income distribution. The table powerfully demonstrates that grants are exceptionally well-targeted. The poorest 20% of households receive the largest amount from grants, not just as a proportion of income, but also in absolute terms. Fully two-thirds of the income for the poorest quintile is attributable to state transfers.

Table 2: Social Assistance Grants and total income, by quintile, 2000 (Per Annum amounts in 2000 prices)

	Quintile 1 (poorest)	Quintile 2	Quintile 3	Quintile 4	Quintile 5 (richest)
Average reported income (p.a.) from social assistance grants	5180	1529	990	841	584
Average total income (p.a.)	7758	11397	18745	36260	115954
Grants as % of total income	66.8%	13.4%	5.3%	2.3%	0.5%

Source: author's calculations based on 2000 Income and Expenditure Survey, Stats SA

Note: Quintiles are based on per capita pre-transfer income; quintiles contain equal numbers of households

2.5 The impact on poverty of the SOAP & CSG

In this section, a microsimulation model is used to investigate the poverty impact of social grants. In this section of the report the results for the two biggest grants, that is the State Old Age Pension and the Child Support Grant, are illustrated. The underlying data for the model comes from the 2000 Income and Expenditure Survey and September 2000 Labour Force Survey, both conducted by Statistics South Africa.

For modelling purposes, we define the poorest 40% of individuals (*before grants*) as "poor" and the poorest 20% of individuals (*before grants*) as "ultra-poor". We then simulate the impact of the two grants assuming that all those who are *eligible* for the grants are able to access the grant.

2.5.1 Effect of SOAP only

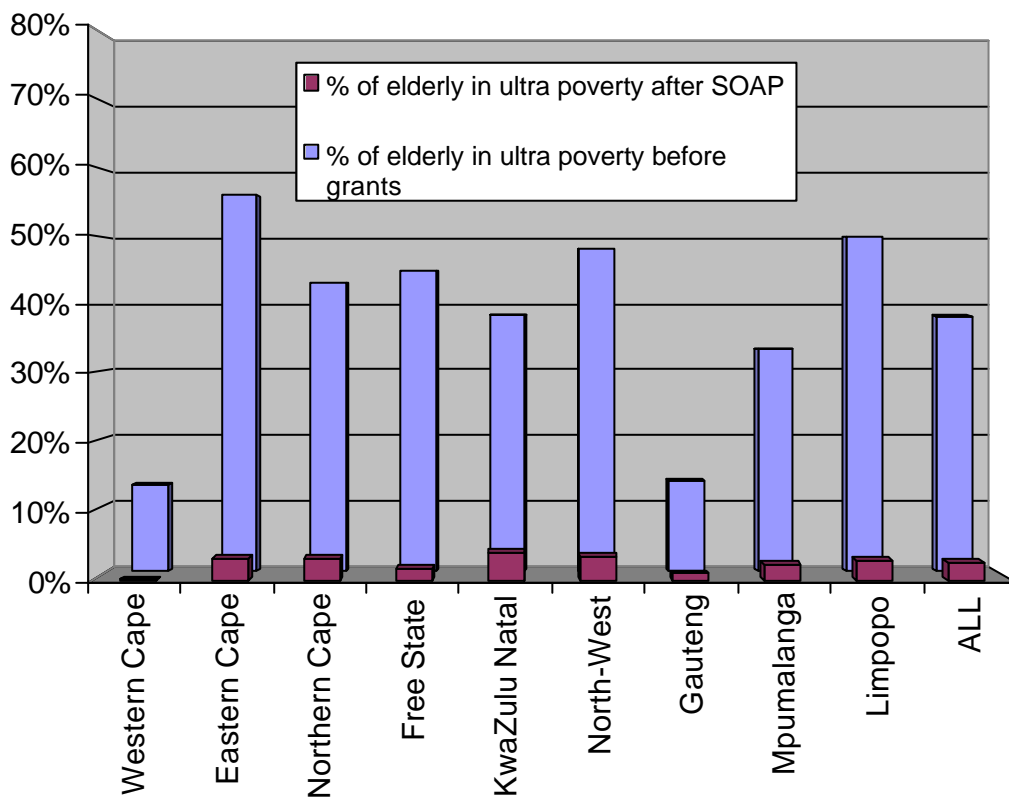
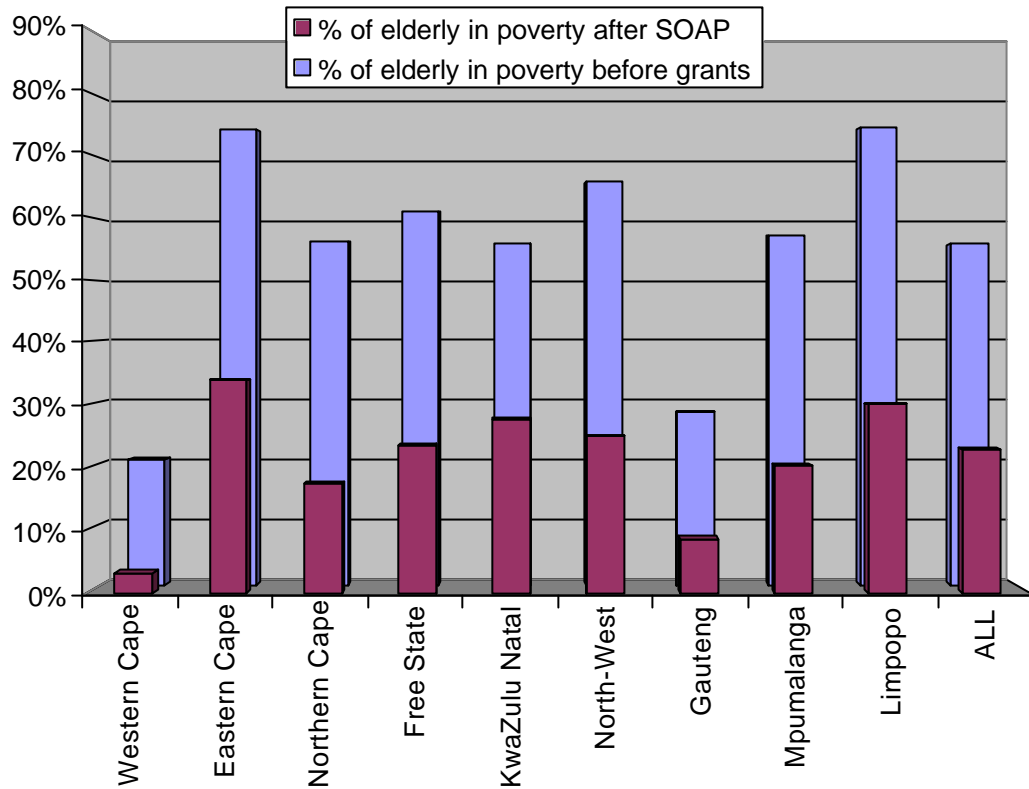
The model estimates that 2,4 million elderly (i.e. 87% of the total elderly population) should be eligible for the SOAP. This contrasts with the figure of 1,9 million elderly who are currently collecting the grant. The figure from the model may be too high, given that concerns have been raised about the income data from the 2000 Income and Expenditure Survey. Nevertheless, for the purposes of illustrating the poverty impact of the SOAP, the data is adequate.

In the absence of any grants, 56.0% of the elderly would be in poverty and 38.2% would be in ultra-poverty. Recall that, by definition, 40% of individuals are “poor” prior to the simulation of the effect of the grant. Assuming that all the eligible register for the SOAP, overall poverty would fall to 33.1% after the SOAP. Even more strikingly, poverty among the elderly falls to 22.6% and ultra poverty among the elderly falls to 2,4%.

Table 3: Impact of SOAP on poverty among the elderly

	Number of elderly according to model ⁴	Number eligible according to model	Number of recipients as at July 2003 (SOCPEN)	% of elderly in poverty before grants	% of elderly in poverty after SOAP	% of elderly in ultra poverty before grants	% of elderly in ultra poverty after SOAP
Western Cape	289890	197948	155138	21.20%	3.30%	13.20%	0.10%
Eastern Cape	526415	499768	410214	74.70%	34%	56.50%	3.10%
Northern Cape	61051	52415	43138	56.40%	17.60%	42.20%	2.90%
Free State	169847	145757	121994	62.00%	23.70%	45.4%	1.20%
KwaZulu Natal	550410	470923	418018	56.50%	27.70%	38.80%	3.9%
North-West	213244	199731	172945	65.60%	24.6%	47.90%	3.50%
Gauteng	492462	385842	242826	28.90%	8.50%	13.80%	1.00%
Mpumalanga	151393	145333	142041	57.80%	20.00%	33.40%	2.20%
Limpopo	317440	303868	310256	75.10%	29.80%	50.00%	2.50%
ALL	2772152	2401585	2016570	56.00%	22.60%	38.20%	2.40%

⁴ The model is based on the demographic data contained in the Labour Force Survey of September 2000, projected forward using the ASSA 2000 model of the Actuarial Society of South Africa.



2.5.2 *Effect of CSG on child poverty:*

The model estimates that 5,0 million (or 66% of) children under 7 should be eligible for the CSG. This contrasts with the figure of 2,9 million children who are currently in receipt of the grant. Again, the figure from the model may be too high, given that concerns have been raised about the income data from the 2000 Income and Expenditure Survey. Nevertheless, for the purposes of illustrating the impact of the CSG, the data is adequate.

It would appear that registrations for the CSG are still lagging in several provinces. In the Western Cape we estimate that 100% of eligibles have registered, while only 47% in the Eastern Cape and 50% in Limpopo have done so.

In the absence of the CSG, 48.0% of children would be in poverty and 23.9% would be in ultra-poverty. Assuming that all the eligibles (under the age of 7) register for the CSG, poverty among children (under 7) falls to 40.8% and ultra poverty falls to 12.9%.

2.5.3 *Combined results*

Despite being targeted at only the elderly, the very young and the disabled, social assistance grants play a large role in redistribution and poverty reduction in South Africa. The Microsimulation estimates suggest that the combined effect of the SOAP, DG and CSG (when extended to all those that are eligible) reduces the number of individuals in poverty from 40% to 24%. The grant system also strongly reduces inequality – the Gini coefficient (computed on per capita household expenditure) falls from 0.67 before grants to 0.62 after grants.

Table 4: Impact of CSG on poverty among children

	Number of children (0-6) according to model ⁵	Number eligible according to model	Number of child (0-6) recipients as at July 2003 (SOCPEN)	% of children in poverty before CSG (or other grants)	% of children in poverty after CSG	% of children in ultra poverty before CSG (or other grants)	% of children in ultra poverty after CSG
Western Cape	643154	208168	209210	13.30%	9.60%	3.40%	1.80%
Eastern Cape	1301901	1022404	484142	67.00%	57.50%	37.90%	21.50%
Northern Cape	136238	84292	51291	49.10%	41.10%	23.80%	13.60%
Free State	453326	308511	165369	52.30%	43.90%	24.20%	12.70%
KwaZulu Natal	1630482	1145422	738962	54.30%	46.70%	29.30%	15.50%
North-West	613848	396534	225444	46.00%	41.20%	24.10%	13.00%
Gauteng	1236271	545063	360911	20.50%	16.70%	7.20%	4.10%
Mpumalanga	587009	383623	226693	41.90%	33.60%	15.50%	7.60%
Limpopo	1204167	955449	474478	65.80%	56.40%	31.80%	17.00%
ALL	7806395	5049467	2936500	48.00%	40.80%	23.90%	12.90%

⁵ The demographic data for the model is based on the demographic data contained in the Labour Force Survey of September 2000, projected forward using the ASSA 2000 model of the Actuarial Society of South Africa.

3 Macroeconomic Implications

This section briefly discusses the relationship between the redistributive effects of social security and economic welfare, where it is implicitly assumed that social security will reduce poverty and enhance equality.

3.1 Relationship between Poverty & Inequality Reduction and Economic Growth

There is some evidence from both developed and lesser-developed countries that high inequality reduces growth. For example, Alesina and Perotti (1996) postulate that income inequality, by fueling social discontent, increases sociopolitical instability. The latter, by creating uncertainty in the politico-economic environment, could then reduce investment and, consequently, growth. They test the model using data for 71 countries for the period 1960-1985 and the results confirm the hypothesis. Similarly, Persson and Tabellini (1994) show that inequality can be detrimental to growth in countries where distributional conflict produces economic policies that tax investment and growth-promoting activities.

Using a median voter model, Alesina and Rodrik (1994) show that the greater the inequality of wealth and income, the higher the tax rate and the lower growth of the economy. They study the relationship between politics and economic growth in a simple model of endogenous growth with distributive conflict among agents endowed with varying capital/labour shares. The factor ownership of the median individual determines his/her voting behaviour and thus the level of taxation, redistribution, and growth. Policies that maximize growth are optimal only for a government that cares solely about pure "capitalists." The greater the inequality of wealth and income, the higher the rate of taxation and the lower growth. The empirical results show that inequality in land and income ownership is negatively correlated with subsequent economic growth.

3.2 The "irrigation" function of social security

The argument which stresses the *negative* impact of the redistribution effect of social security on economic activity is based on Okun's well known argument of the "leaky bucket". Okun made this analogy as a means of conceptualizing the hidden cost of efforts to reduce relative poverty in a society. The "leaky bucket" is a symbol for the resource waste inherent in the bureaucratic activity of organizing the income transfer. It also symbolizes the opportunity cost of the lost output as a result of diminished work incentives due to the redistribution of income. Okun imagined the government as a person carrying water in a leaky bucket which had been taken from the wealthy household, in order to bring it to the poor household. The leaking water pouring out of the bucket represents an "efficiency loss." The lost water does not benefit either type of household. It just ends up poured out on the ground. It is an efficiency loss in order to achieve more equality. According to this argument, then, social security expenditures are thrown into a leaky bucket and thus the welfare loss of those who pay the social security premiums is larger than the welfare gain of those who benefit from social security.

According to those who argue that social security has a *positive* effect on welfare, Okun's metaphor of the leaky bucket is incorrect because it assumes that we live in a world with complete information and with well-functioning markets. However, in the

real world the redistribution of social security may very well enhance economic welfare. In particular the so called *irrigation function* of social security is put forward as an alternative to the leaky bucket of Okun (den Butter & Kock, 2001). According to this theory a positive relationship between social security provisions and economic performance can exist because the lack of social security may be an impediment for the functioning of labour market dynamics. These labour market dynamics whereby old jobs are destroyed and new jobs are created play an essential role in economic development. It would be harmful to economic activity when the process of structural change which brings about job creation and job destruction, was hindered by impediments resulting from the labour market. If workers are able to rely on the social safety net they will not be too reluctant to give up the old job when it has become unproductive. Instead they will be more eager to search for a new job with the expectation that the search process results in a good match between their own capabilities and the requirements for a new job, so that the match becomes as valuable and productive as possible. At the macro level this implies that the processes of job destruction and job creation, and hence of structural change, can proceed. In the end this is beneficial to productivity and therefore to economic welfare.

It might be considered that this line of argument is relevant only to the provision of unemployment insurance. But the provision of broader social assistance grants also goes some way towards providing workers with the necessary cushion which permits them to choose to search for new jobs rather than remain in relatively unproductive jobs such as those in subsistence agriculture or the informal sector.

3.3 Implications of the Financing of the Pay as You Go Social Old Age Pension for Economic Growth

The state old age pension is funded on a Pay as You Go (PAYG) basis, i.e. benefits for today's elderly are financed via current taxes. The financing of the state old age pension thus affects economic growth via savings because taxes levied on the working generation reduces total savings in the economy. However, the expected effect that this will have depends on the underlying assumptions we make about the determinants of economic growth. Early analyses of economic growth were usually done within the framework of the neo-classical growth model, as developed by Solow (1956). In the Solow neoclassical growth model

$$g_y = \beta g_k + (1 - \beta)(g_A + n)$$

where g_y , g_k , and g_A are the growth rate of output, the growth rate of capital, and the growth rate of technology. β is the income share of capital in the aggregate Cobb-Douglas production function. n is the growth rate of population. Since savings determines g_k , the state pension affects the growth of the economy via g_k . By definition $g_k = \frac{S}{K} = \frac{S/Y}{K/Y}$, where S , K , Y represent savings, the capital stock, and output, respectively. Obviously the reduction in savings immediately causes the reduction of the growth rate. However, the long-run effect is not clear as in the long-run, the capital output ratio also falls. Therefore a reduction in the savings rate lowers the level of output but does not affect the steady state rate of growth.

If, however, we assume that the correct growth model is the "AK" (Auerbach-

Kotlikoff) model, then the effect of the financing of the PAYG state old age pension on economic growth differs. In the “AK” model the steady state growth rate of the economy is:

$$g = g_y = g_k = \frac{S}{K} = sa(L)$$

where $sa(L)$ is the savings of the labour force. According to this, the reduction of the savings rate *always* causes the reduction of the growth rate. To further understand the impact of the state pension on economic growth, the overlapping generations model is needed to explain an individual’s saving behaviour. From the overlapping generations model, the optimal saving behaviour of an individual is:

$$s = \mathbf{s}(1 - t) - t(1 - \mathbf{s})(1 + g)/(1 + r)$$

where s is the savings rate. \mathbf{s} is the elasticity of the substitution of consumption between two periods. t is the income tax for financing the state pension and r is the discount rate. Therefore, the impact of the state pension on economic growth depends on the comparison between the growth rate of the economy (g) and the discount rate r faced by individuals. If $g=r$, the state pay-as-you-go pension has no impact on economic growth since the state contributions displace private savings at the same rate. If $r > g$, it is evident that the existence of a state pension reduces savings, and the reduction in the savings rate reduces the growth rate in the long-run.

4 Conclusion

Social assistance in the form of cash grants from the state is quite unusual in the developing world. Compared to most other middle-income countries, South Africa possesses a substantial system of cash transfers, mainly in the form of old age, disability and child grants. The relatively advanced level of the grant system is one of the legacies of apartheid as the system was designed as part of the White welfare state. Yet, while other countries were scaling down on social spending, South Africa introduced a new grant for children in 1998 and expanded this further in the current fiscal year.

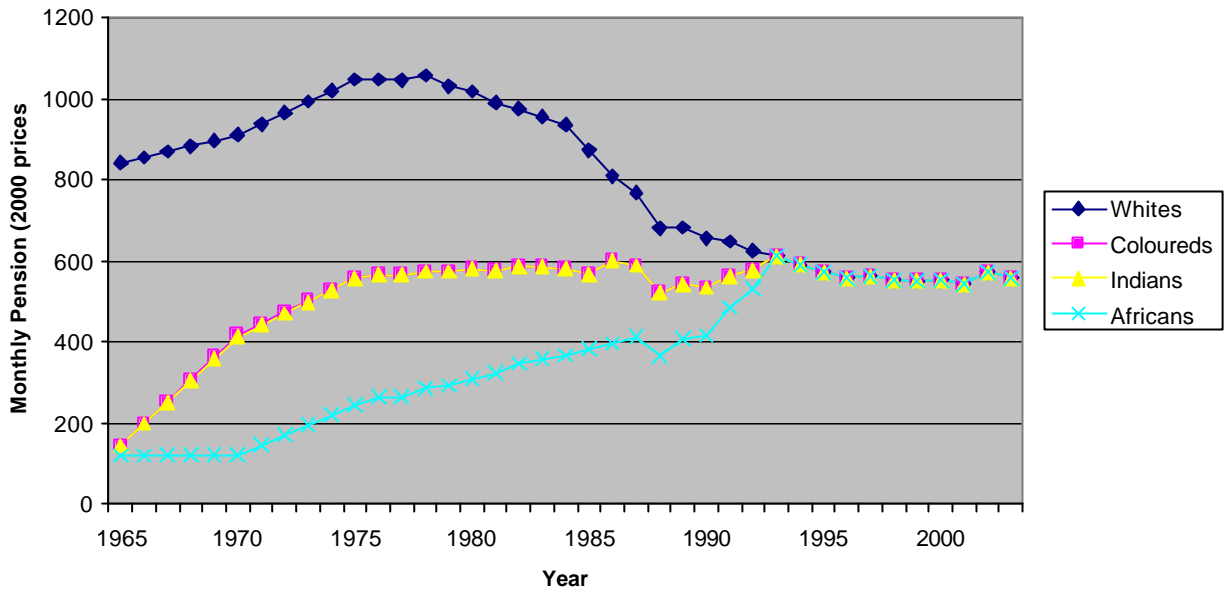
Despite being targeted at only the elderly, the very young and the disabled, social assistance grants play a large role in redistribution and poverty reduction in South Africa. Estimates based on household survey data suggest that the combined effect of the SOAP, DG and CSG (when extended to all those that are eligible) reduces the number of individuals in poverty from 40% to 24%. The grant system also strongly reduces inequality.

There is some evidence from the international literature to suggest that this reduction in poverty and inequality is growth-enhancing. At the same time, there is evidence to suggest that the financing of an ambitious social assistance programme through higher (and potentially distortionary) taxes or higher budget deficits may dampen growth. This is clearly an area that needs further work in South Africa.

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Figure A1: OAP by race, 2000 prices



Source: Data supplied by Servaas van der Berg, University of Stellenbosch