Can pension funds dance to a working class tune?

__Ravi Naidoo__ argues that the domestic private pension fund industry provides South Africa with a powerful resource to accelerate economic development and worker influence over companies.

Amidst all the gloom of globalisation, one major opportunity presents itself to the labour movement. Pension funds, whose funds are composed largely of savings of ordinary people, are becoming increasingly dominant at a global and national level. In many countries, contributions to pension funds are legally defined as 'deferred wages'. As a result, the rights of workers to control the management of these funds are increasingly recognised – and so too, in theory, is the potential for workers to use pension fund capital to leverage power in the economy. Remarkably, South Africa may be the country where the labour movement has the most opportunity to make pension fund advances.

Pension funds in SA

South Africa is the biggest 'pension fund country' in the world. The strength of the South African economy lies with its institutional investors, with total assets of R1 000-billion or 50% of South Africa's total asset value. Pension funds account for R600-billion of institutional investor assets, owning 60% of the equity listed on the Johannesburg Securities Exchange (JSE). Pension fund contributions from the 80% of the formally employed amount to over R54-billion a year – 14% of total personal remuneration in South Africa. As a result, South Africa is fourth in the world for per capita pension fund assets, after the United Kingdom, Switzerland and the Netherlands. In terms of private pension fund assets to gross domestic product (GDP), South Africa is first in the world.

Central to the prominent role of pension funds in South Africa is apartheid's history. Skewed wealth and income distribution, created on the back of super-exploitation of the majority of the population, combined with regressive taxation arrangements, acted as the impetus for massive resources being invested in pension funds. Between 1958 and 1996, over 14 000 private pension funds were created, almost one each day on average.

In the post-apartheid era, the presence of a powerful pension fund industry is positive for three reasons. First, the future income of a significant proportion of citizens is well provided for. South Africa is more able to focus on eliminating poverty and job creation, without having to compensate for bankrupt social security systems, unlike many developing economies such as those in Eastern Europe. Second, the financial services sector has developed substantial skills and expertise that can prove useful in building the local economy. Third, the fully funded status of private pension funds has resulted in the accumulation of a tremendous stock of assets. This stock of assets could be a potential source of capital to finance reconstruction and development, much like such assets were used to finance the apartheid state prior to the mid-1980s (when 40% of pension fund assets had to be invested in apartheid government bonds).

Social investment

The role of the pension fund industry in promoting socially targeted investments, though this time for Reconstruction and Development purposes, has emerged strongly. In South Africa investment as a percentage of GDP has fallen from 25% in 1981 to less than 16% in 1999, far below the levels regarded as necessary for adequate economic growth to be achieved.

The reasons for this decline of investment remain the subject of heated debate. Business and some in government argue that local capitalists are 'waiting' for a better moment to invest, because of underlying 'low investor confidence'. COSATU calls it an 'investment strike', where local capitalists are sabotaging the transformation process, and would rather hoard their capital in cash than convert it into real investments on the ground. However, regardless of whether one regards the problem as being 'excessive waiting' or an 'investment strike' the result is the same: the capitalist class is not investing in the economy. *Indeed, via offshore investment and primary listings, almost 50% of South African capital is now offshore – when only a portion of this capital would be sufficient to, for example, address the entire South African infrastructural backlog.*

So how does a developing country ensure the capital that was accumulated within its borders, through exploiting local resources, gets reinvested locally? After all, ensuring that local capitalists invest locally is a primary accumulation strategy adopted by the now developed countries. Looking into this issue, the Black Economic Empowerment Commission (BEECom), representing mainly black business, focuses on pension funds. Central to BEECom recommendations is a call for a more interventionist government, leading an Investment for Growth Accord. The proposed accord, to be reached through a process of social dialogue, will promote pension funds being channelled into socially targeted (productive) investments, through social consensus or through government intervention. The current Committee of Inquiry into a Comprehensive Social Security System for South Africa, a body appointed by Cabinet, is also looking into the pension fund industry – and also considering ways to promote productive investments.

There is a clear logic to getting pension funds to boost domestic growth, development and job creation. First, pension fund assets belong to citizens of South Africa, and the accumulated capital should in the first instance be invested in benefiting citizens and the local economy. Second, there is a strong correlation between employment levels and the stability of pension funds.

When the economy is in recession, more jobs are lost and the funds pay out more than they receive. When jobs are

Pension funds are made up of savings of ordinary people's money.

being created, funds pay out less and receive more by way of increased membership and contributions. Third, pensioners require individual and community assets (such as housing and local infrastructure) and not just retirement incomes. So there is a role for massive pension fund investment in such asset creation without compromising adequate retirement incomes.

Will the labour movement play a decisive role in these debates? Certainly labour is an important and influential stakeholder. In 1981, for example, the apartheid government's attempt to impose compulsory preservation of retirement savings was effectively resisted by unions, which argued that in the absence of a social security system retrenched workers must be allowed access to their savings. Recently, the labour movement has joined the debate, proposing the reintroduction of prescribed assets (now described as 'socially targeted investments' to distinguish it from the apartheid regulations), and channelling investment into housing and infrastructure, thereby increasing asset accumulation among the majority of South Africans disadvantaged by apartheid.

Socially responsible

What can be done to make investment more 'socially responsible'? A universal prescription on funds through socially targeted investments, social consensus or government intervention, is one option. To pre-empt this intervention, there have been attempts in the past to develop a more voluntarist approach to fund investment.

The main effort was through so-called socially responsible investment funds (SRIFs). In June 1998, *Financial Mail's* Top

Companies identified 19 SRIFs with combined assets of R8,1-billion. At that time, R8-billion was only 1% of total institutional investment assets, hardly inspiring stuff.

These SRIFs were often spin-offs of larger funds, intended to focus on very broadly defined 'reconstruction and development (RDP) investments'. Indeed, many of the RDP investments were really nothing of the sort. For the few genuine RDP investment initiatives, a major problem was the lack of institutions and skilled individuals that could identify opportunities and facilitate the ongoing operations. So actual RDP investment, in the sense of productive investments, was limited.

In fact, the portfolio composition of SRIFs was basically the same as that of pension and life insurance funds as a whole. The largest asset overall was equity, and not productive, non-equity investments. In 1998, approximately 70% of or R3,3-billion in assets from the ten largest SRIFs were invested in equity. There were even cases where one SRIF held equity of another SRIF. *In short, the 'socially responsible investment' attempts generally got caught up in the same speculative equity paper chase.*

Worker control

It is common to have critics slam union calls for state-enforced socially targeted investments by pointing out that supposedly union-dominated funds are not doing enough themselves. The implication is 'don't criticise us, start with yourselves'. So it is worth looking into why the supposedly union-dominated pension fund industry does not do enough.

First, pension funds generally do not manage their own funds. Often only large pension funds find it worthwhile to develop the capacity to manage funds internally, and most private funds are turned over to an external asset manager. These asset managers are usually life insurance companies. The exceptions are the largest pension funds such as the Mine Officials and Mine Employees who manage 100% of combined assets themselves.

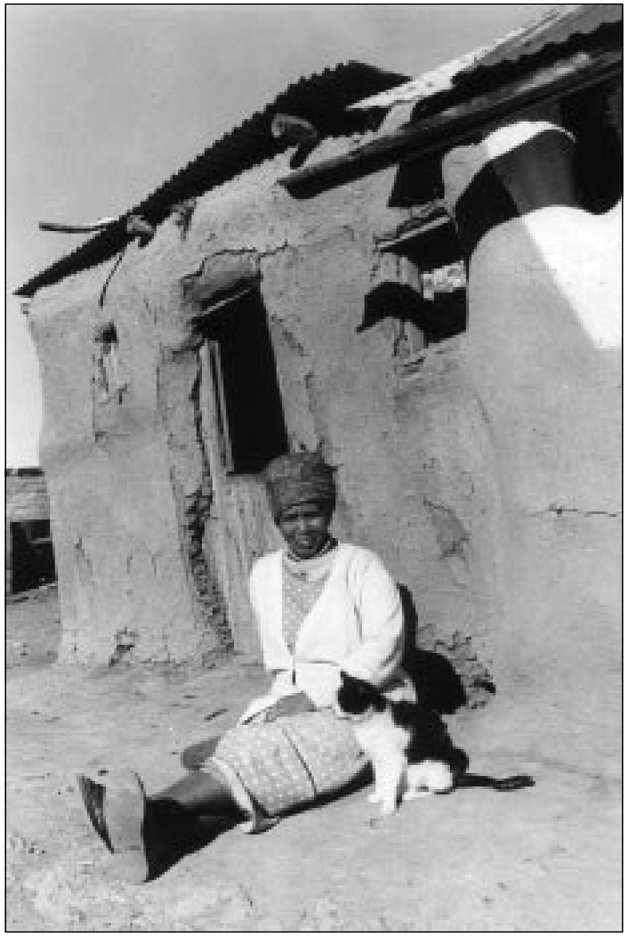
In short, economies of scale play an important role in the accumulation and management of retirement assets, especially the flow of funds to socially targeted investment. Consolidating small funds into industry funds is one way to create the potential to exploit economies of scale. In this way, COSATU's demand for industry and national funds support will probably bolster any drive towards higher levels of social investment.

Second, those who currently dominate pension fund asset management are not supportive of longer-term investments. Crucially, the asset managers for life insurance firms are judged on their short-run results, not on their contribution to longer-term development. So there is great resistance from the asset management industry to RDP investments. Unfortunately, life insurance companies are the largest asset managers in South Africa. They manage the majority of private fund assets. Indeed, since 1994, life insurers have managed all new contributions to the central government's pension fund, the Government Employees Pension Fund (GEPF).

Not only is concentration in the asset management industry extreme, but concentration in the life insurance industry is even more extreme. In 1996, 93% of all life insurance business was from seven life insurers. Of these seven, five are among the top ten asset managers of pension and provident funds.

Third, while pension fund trustees

should set the asset managers' agenda, in reality there are many institutional and capacity barriers to workers converting their legal rights into effective control of pension funds. In particular, employers, not workers, have almost always run pension funds single-handedly. In this regard, an important amendment was made to the South Africa Pensions Fund Act in 1996. The amendment, which came into effect from January 1999, gives members a minimum of 50% of every Board of Trustees. Previously, there was no minimum member representation, with employers usually having total control of the funds, with numerous corporate governance problems resulting. (It was common, for example, for employers to manipulate the pension fund rules, wind down their business, and then take an unfair share of the fund's assets.)



Pension funds should be used to boost domestic growth, development and job creation.

Yet the legislative change, by itself, is not sufficient. Workers and trade unions often lack the technical skills to confidently manage funds, especially in the face of severe management and market hostility to alternative approaches. So while the board of trustees of the fund designs the members' mandate, in practice private funds tend to pass on the members' mandate to an asset manager. Private fund trustees often give the asset manager (whether investment company or life insurer) full or partial discretion. For example, the Cape Joint Pension Fund stipulates only that assets are not be taken offshore, yet beyond that asset managers can invest as they see fit. In short, where workers do get control of funds, they are herded into management and investment patterns that are identical to those of employer-driven funds.

Not surprisingly, then, *the current pension fund influence on companies is perverse from a working class perspective.* For example, JSE-listed companies that announce plans to downsize workforces, and hence increase profitability, see their share prices rise in response – and hence offer their pension fund investors better returns. But it may be these very same worker investors that will

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dominated funds could exert a similar power over companies, but this time to ensure improving labour standards or pro-worker workplace transformation.

In reality workers, via their pension funds, cannot avoid becoming shareholders of companies. They are increasingly gaining legal rights over these pension funds. The question is really whether they choose to exercise their potential influence passively or actively.

The passive approach is where the South African situation is at: workers outsource their influence over these funds to private managers, so that they can concentrate on regular union business, such as fighting for better wages and working conditions! A more active strategy, however, recognises that shopfloor struggles and pension power are mutually reinforcing.

The active strategy, which is gradually gaining ground, recognises that by using the pension power that exists, unions can effectively double their pressure on companies for better wages and working conditions.

Essentially, an active approach can take two forms, namely an 'exit' or a 'voice' strategy. An 'exit' strategy is an approach whereby investments held in anti-union or bad labour practice companies are sold. The rationale is that the resulting lower stock price should force companies to change their behaviour, though this 'exit'

be retrenched! Such a vicious cycle is clearly occurring where most South African formal sector workers have pension funds, whose funds are leading major downsizing and retrenchments cutting formal sector employment by 400 000 jobs in the past four years.

Pension fund socialism

Through the massive pension fund share of the JSE, workers could exert increasing influence over companies. This is exactly what cutthroat institutional investors do around the world when they force companies to slash their workforces, and increase short-term profitability. Worker-would be better held in threat than actually acted on. A 'voice' strategy, on the other hand, requires that workers use their new shareholder role to struggle for greater worker influence over company corporate governance. In particular, shareholders have the possibility to introduce shareholder resolutions at annual general meetings, or even vote out management. Through collectively owning 60% of the JSE, such a pension fund 'voice' strategy – combined with active shopfloor organisation – could have a major impact on how companies are run.

Pro-employer analysts, realising that pension funds will over time grow as a share of total available capital, have long feared this scenario. One leading analyst referred to it as 'pension fund socialism' when workers own larger and larger shares of the economy. However, as mentioned earlier, many institutional and capacity barriers have been actively encouraged by employers to forestall such possibilities for now.

Where to now?

First, the international labour movement needs to build a campaign to get control of pension funds, and utilise this 'worker capital' for a working class agenda. Indeed, the international labour movement is increasingly aware of the power of worker contractual savings. These funds collectively amount to an estimated US$6-trillion globally, and are among the most dominant institutional investors in global financial markets.

The International Confederation of Free Trade Unions (ICFTU) has therefore set up a working capital strategy group to explore ways for workers to recast these funds to their own advantage. This group will facilitate internationally co-ordinated trade union responses to the working capital challenges. Naledi, via the South African trade union movement, is involved in this process.

Second, worker trustees need to be trained and legislation needs to be introduced to further remove institutional and capacity barriers to worker control in the pension fund industry. This means that unions need to redouble their efforts to consolidate existing small funds into larger industry funds, with economies of scale that can facilitate union asset managers. Crucially worker trustees must be trained in taking forward a working class agenda. It is after all of little value to have worker trustees if they, too, prefer offshore investments.

If domestic pension fund and life insurance fund assets are channelled into some form of socially targeted investments, opportunities and capacities to utilise the funds effectively must be developed. There must be institutions and individuals that can manage RDP investments: identify areas that can benefit, channel funds to infrastructural and housing projects, and facilitate the ongoing operation of projects. This also requires investigating the entire asset management industry and how it can be transformed to facilitate such productive investment.

In conclusion, pension power is not an alternative to strong working class organisation and struggle. However, the unique size and importance of the domestic private pension fund industry provides South Africa with a powerful resource to accelerate economic development and worker influence over companies. The organisational strength of the union movement combined with the recent trustee legislation provides a key to unlock that potential. Can this opportunity be grasped? ★

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