Pension funds
investing in growth and employment

by RAVI NAIDOO

The South African economy suffers from insufficient investment in productive activities. Pension fund assets could be used to boost development.

South Africa has a large and powerful pension fund industry, an industry that could be mobilised to boost investment in growth and job creation. This has been a COSATU demand since 1993. Conservatives, however, continue to resist this demand on the basis that intervention in the industry would 'distort the markets' and that investment would naturally flow as government adheres to neo-liberal economic policies. Yet investment has not picked up from its painfully low levels. Not surprisingly, the debate regarding the mobilisation of 'pension funds' (including other retirement funds, such as provident funds) has now re-emerged on the national agenda.

A powerful industry

Members	Contributions	Assets
R8,4 million	R52 billion	R694 billion

The table, using the latest official figures from 2000, reflects pension funds assets of R694 billion. Estimates for 2003 put total pension fund assets at more than R800 billion. Despite its status as a developing country, South Africa is first in the world in terms of private pension fund assets as a ratio to Gross Domestic Product (GDP).

It is estimated that total pension fund contributions amount to more than R52 billion a year. It has also been estimated that there is another R8 billion in contributions to retirement annuities and a further R27 billion in regular premium life assurance contributions intended to mature at retirement. In total, it is estimated that a massive 20% of total personal remuneration in South Africa goes towards retirement contributions.

Investment

Despite the enormous financial resources held by the pension fund industry, the South African economy suffers from insufficient investment in productive activities. Investment has fallen from 25% of GDP in 1981 to 14,7% in 2001. One reason for this low level of investment is the massive outflow of capital. South Africa's largest companies have moved their headquarters to London and New York, resulting in a net capital outflow of R37 billion in 2000. In addition, the state (including state-owned enterprises) has been heavily cutting back on investment.

Building apartheid

During the apartheid era, prescribed asset legislation was used to generate investment. This legislation was introduced in the Pensions Fund Act of 1956. It was compulsory for every fund to invest at least 10% of its total assets in government stock and another 40% in other prescribed stock (which also included government stock). These figures peaked at 22,5% and 55% respectively in 1977 at the height of apartheid. Prescribed assets included National Defence Bonds, Iscor, Sasol, various water services, economic development, homeland development corporations, etc.

'Total pension fund assets in 2003 stand at more than R800 billion.'

It is interesting to note that, during apartheid, capital and the white population generally accepted these prescribed assets. Many funds actually invested voluntarily, at higher levels than were required. This started to change in the 1980s, when the apartheid system delivered falling rates of returns (negative in some cases) and there were clearly dwindling benefits to supporting the apartheid system.

Under enormous pressure from capital, and wishing to keep prescribed assets out of the hands of a future democratic government, the apartheid government abolished prescribed assets in 1989. At this stage, the prescribed assets requirement stood at 53%. In short, pension funds were used, with the full consent of capital and the rich, to bolster the apartheid state. As democracy dawned, this instrument was strategically withdrawn.

'Socially targeted investments'

The Reconstruction and Development Programme (RDP) drawn up in 1993 recognised the importance of the pension fund industry to South Africa's development. The RDP stated that if financial institutions do not voluntarily go for "socially desirable and economically targeted investments", then laws should be passed to stipulate that a certain part of all pension and provident funds must go into certain government-endorsed projects.

At the Presidential Job Summit in 1998, COSATU pushed hard for some form of socially targeted investments. This issue was negotiated at one of the technical working groups, where the Department of Finance joined white capital in fiercely resisting the proposal.

Recently, black business reintroduced the issue. The Black Economic Empowerment Commission report, tabled in 2001, focused on the establishment of an "Investment for Growth Accord". This Accord would promote the channelling of pension fund assets into socially targeted investments, through social consensus or through government intervention. Once again, conservatives in government blocked this proposal, while accepting many of the other proposals from the Commission report.

The reality of low investment has meant that the issue will not go away. Support for the proposal is gaining ground. However, in the face of relentless trade union pressure, there has been a entrepreneurial effort to turn the debate on its head. Union critics have resorted to stating the problem is with union trustees who are not doing enough to invest productively. This is despite the fact that 'union controlled funds' make up less than 2% of the industry and in reality assets managers (such as Old Mutual or Sanlam) control pension fund investments.

'COSATU is pushing hard for some form of socially targeted investments.'

Indeed, in behind-the-scenes negotiations these large asset managers admit to having an inherent short-term, speculative investment bias. Since funds are assessed on quarterly results, any fund investing long-term will lose members to other funds with better short-term results. This is, in fact, an argument for government to impose a standard socially targeted investment rule for all funds.

So it was both an advance and a disappointment when President Thabo Mbeki, in a televised interview after this year's State of the Nation Address, raised COSATU's long-standing proposal on pension fund investment – but then suggested only union controlled funds be pressured to invest in jobs.

What is to be done?

Morally and strategically, it appears as if it is up to trade unions to take the lead. In this regard, it may be best if trade unions tabled the following proposal at the Growth and Development Summit:

Union controlled funds will put, say, 10% of their assets into socially targeted investments. The following preconditions would apply, however:

- The State must ensure that an equivalent requirement applies to all other funds, either through binding agreement in the industry or government legislation. No fund should be allowed to 'free-ride' on the economic spin-offs generated by other funds increasing productive investments. All funds should be required to invest 10% of their assets into a socially targeted 'investment universe', which sets out a range of investment options. It is estimated that a 10% socially targeted requirement for retirement funds and long-term insurers would increase such investment by more than R128 billion a year.
- The 'investment universe' should be based on an agreed growth and development strategy. This strategy could identify investments in infrastructure (such as roads), and in productive activities, such as completing employment-intensive 'value chains' (eg investment in downstream activities). Even if an agreement on a growth and development strategy is not reached, the government can still use state-owned institutions such as the Industrial Development Corporation and the Development Bank of South Africa to play a leading role in identifying appropriate socially desirable investment projects.
- Fund members must be protected from excessive risks. Where actual (as opposed to 'perceived') risks are identified, government should put in place measures such as co-investment or investment guarantees. Government could put together a universe of different projects/ investment options with different rates of returns and risk profiles, thus reducing the overall risk to a particular fund. Government could also introduce a new bond for pension funds, something that funds are already clamouring for in the current climate of uncertain equity markets.