ALLAN GRAY

GRAY ISSUE
24 August 2020 **Issue 234**

Will prescribed assets be used as a policy tool?

Reports that the government plans to compel pension funds to invest in state assets and projects have understandably caused alarm among investors, spurring many questions. However, according to the ANC's economics chief, Enoch Godongwana, the party is moving away from the idea that prescribed assets be used as a policy tool. How do you make sense of these conflicting reports? Sandy McGregor provides some much-needed context and tackles this question.

There is general agreement between business, the government, and the ANC, that boosting infrastructural spending is both necessary and an appropriate way in which to get the economy growing again. Some parties to this discussion believe that in its current form, Regulation 28 of the Pension Funds Act – which stipulates the assets that retirement funds can invest in – is too restrictive. They believe it needs to be changed to give pension fund trustees greater freedom to invest in infrastructural projects.

While greater clarity and flexibility is always welcome, changing Regulation 28 is probably unnecessary. Pension funds are already investing in infrastructure through debt securities issued by parastatals such as Eskom, Transnet, the Trans-Caledon Tunnel Authority (TCTA) and the South African National Roads Agency (SANRAL). The discussion about changing Regulation 28 is therefore the wrong discussion. The problem is not – nor has it been – the availability of funds, but a lack of suitable projects. During the past decade, state institutions tasked with infrastructural development have been crippled by gross mismanagement and endemic corruption. Most public sector institutions have become uninvestable without a government guarantee. By way of contrast, where the private sector was allowed to take the lead, such as in the mobile phone network, renewable energy, commercial property and private housing, there has been significant continuing investment for which finance has been readily available.

The way to get investment going again is to fix the various state institutions involved in infrastructure and give them greater freedom to recruit private sector skills and resources to fulfil their mandates. Viable projects can be financed whether it be by banks, pension funds or other savings institutions. Usually non-viable projects should not proceed in the first place, but if they are judged to be in the public interest, they should be financed by the state.

Currently Regulation 28 is a prudential and not an economic requirement. The National Treasury and Reserve Bank have long been opposed to subjecting pension funds to prescribed asset regulations. Given the shortage of suitable projects, regulations compelling pension funds to hold a proportion of their assets in infrastructure may force them to make inappropriate investments. This would be a wasteful application of South Africa's inadequate savings and have a cost in the form of lower economic growth and reduced pensions.

One important point to note, and often overlooked safeguard, is that the proposed changes to Regulation 28 will not relieve trustees of their fiduciary obligation to act prudently in the interests of their fund's members. Following the tabling of the revised 2020/21 Budget, the Minister of Finance said that he favoured changes which facilitate pension fund investment in infrastructure, but there would be no compulsion to do so. Subsequently the ANC's economics chief, Enoch Godongwana, has said the ANC is moving away from the idea that prescribed assets be used as a policy tool; rather it wishes to create an environment in which pension fund trustees can invest in infrastructural projects – provided they are profitable.

South Africa has annual savings equal to about 15% of GDP and in the present fiscal year a deficit equal to 15% of GDP. Even in the most optimistic projections, state borrowing will crowd the private sector out of capital markets for years to come. To get through what are going to be difficult times, we need an efficiently operating capital market, which the Treasury can access as it has in the past. Imposing further complicated regulations on the savings industry would make the difficult task of funding the fiscal deficit even more difficult. Notwithstanding public conjecture on this issue, Treasury is well aware of this. The simplest way to alleviate the savings shortage is to seek foreign investment. President Cyril Ramaphosa's laudable initiatives in this regard have suffered a serious setback due to the COVID-19 crisis, with many projects delayed or cancelled. The US$5.3bn borrowed from the International Monetary Fund (IMF) and New Development Bank (NDB) is equivalent to about R93bn but this will be needed to partially compensate for the expected R300bn shortfall in tax collections in the 2020/21 fiscal year.

Funding is also available from other multilateral institutions, including the World Bank. There are two parastatal institutions which may be able to meet the requirements of these lenders relatively quickly: Transnet and SANRAL. While Transnet was subject to serious looting during the Zuma administration, it now seems to be getting its house in order. It has a backlog of necessary projects. Its balance sheet is strong enough for it to fund itself in the domestic market without government guarantees. The benefit of funding Transnet offshore will be a reduced call on the domestic savings pool. The same would be true of SANRAL, which has been one of the better-managed state institutions but has been financially crippled by the tolling crisis. It has a backlog of projects throughout the country, which would provide a widespread economic stimulus. Establishing some structure enabling SANRAL to service its toll-road debts would free it to raise capital to proceed with these projects. A repurposed SANRAL could also be a candidate to seek concessional external funding. South Africa has become notorious for pronouncing grand plans without any subsequent action, probably because the planners have been too distant from where the real work is done. Certainly the current fiscal situation renders most plans for a greater role of the state in the economy unworkable. However, there are some things which can be done. Tapping internationally available concessional finance to reinvigorate parastatals such as Transnet and SANRAL would be a good way to start reversing this unhappy narrative. Creating a business-friendly environment which would promote private investment is another.

Commentary contributed by Sandy McGregor, portfolio manager, Allan Gray