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AIDC
Alternative Information & Development Centre
Strengthening Alliances for a Wage-led, Low-Carbon, Sustainable and Equitable Development Path for Southern Africa

The Public Investment Corporation & financing a just transition: Briefing Note

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It is clear to every South African that the crisis at Eskom needs to be resolved as a matter of urgency. However, many of us are coming to fear the proposed solution almost as much as the problem. At the moment, the government is looking down a road that will most likely lead to some form of austerity and privatisation. Tito Mboweni's Special Appropriation Bill, which removes R59 billion from the national budget, has already heralded the beginning of this process. This is a road South Africa can not afford to go down; there is no fat that can be trimmed from the budget without hitting bone, especially not in education, infrastructure, health, or social services.

At the same time, we cannot avoid the basic fact that there is no economy without Eskom; South Africa *has* to find the funds to bail out Eskom. To this end, AIDC's research has identified the Government Employee Pension Fund (GEPF), and the Public Investment Corporation (PIC) which manages the GEPF's assets, as resources uniquely situated to deal with the Eskom debt crisis. AIDCs research has shown that the PIC holds a vast surplus that is unnecessary for the guaranteed payment of pensions, and is currently overinvested in corporate equity. A large portion of this surplus can be shifted to Eskom in the form of a zero-interest loan *without* endangering worker's pensions or the survival of the PIC and GEPF. This move, essentially a shift in investment policy from corporate shares to government bonds, is clearly preferable to austerity measures such as budget cuts or the sale of Eskom assets. Additionally, AIDC insists that a PIC-funded Eskom bailout must also come with conditions requiring the restructuring of the PIC in order to expand its mandate and to ensure its future accountability and transparency.

We also present a substantial argument in favour of using the GEPF as a tool in service of a progressive and imaginative socioeconomic policy that goes beyond bailouts and minor reforms. The GEPF has both the resources and potential to be radically reformed in a way that changes its mandate to something like that of a Sovereign Wealth Fund (SWF). This transformed GEPF could drive a South African "New Deal", channelling its vast resources into radical economic diversification, massive infrastructure drives, and play a leading role in beginning our "just transition" away from fossil fuels.

Why use the PIC and GEPF?

Surplus, underfunding, and the safety of government pensions:

The Public Investment Corporation works much the same as any private asset manager, with the main differences being, (i) that the PIC's sole "shareholder" is the South African government, and (ii) that most of its capital comes from the Government Employee Pension Fund (GEPF) and Unemployment Insurance Fund (UIF). The PIC controls over R2 trillion in assets, of which over R1.8 trillion belongs to the GEPF. This massive wealth of funds is further bolstered by ongoing yearly surpluses, with the GEPF's alone averaging around R47 billion per year for the last five years.

Billions of rand	Government Employee Pension Fund (GEPF), 2010/11 - 2017/18							
Budget Reviews	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Contributions	40	44,2	47,9	52,2	56,4	60,3	65,5	70,4
Investm income	40,6	44,5	49,9	54	68,5	69	69,5	72
Contrib & Inv. Inco	80,6	88,7	97,8	106,2	124,9	129,3	135	142,4
Benefits paid	29,9	37,2	43,2	57,9	85,8	83,1	88,3	94,9
Surpluses	50,7	51,5	54,6	48,3	39,1	46,2	46,7	47,5
Cash flow account for GEPF's finances. Source: Treasury's Budget Reviews, 2017 - 2019 and own calculations.								

Government Employee Pension Fund cash flow account in Rbns, 2010 - 2018

Would the use of these funds put pensions at risk?

AIDCs research has shown that this will *not* be the case. The primary argument made is that the guaranteed payment of pensions does not require the use of all of the GEPF's assets. The GEPF's assets currently cover 108% of the liabilities owed to its members, but no pension scheme has to actually pay 100% of its liabilities to all members at the same time - pensions are paid bit by bit over the course of decades. Furthermore, new members continue to enter the pension scheme and provide additional contributions. Therefore, in reality, no pension scheme needs to be 100% fully-funded. This is why our current legal requirement stipulates 90% funding rather than 100%, and why rating agencies like Standard & Poor's only regard a funding level of less than 60% as "weakly-funded". It is possible for the GEPF to go right down to this 60% level (and theoretically even further), while still guaranteeing the defined pension benefits *and* making a surplus on its investments.

The above forms the core pillar of AIDCs argument: reforming the GEPF from an overfunded to an underfunded "pay-as-you-go" scheme will free up to 48%[1] of the GEPF's funds *without* risking either pensions or a credit rating downgrade. This 48% comes out to over R800 billion, a colossal sum with the potential to not only solve the Eskom debt crisis, but also to fund a mass investment drive in our infrastructure and economy.

A secondary argument for the use of PIC and GEPF funds is that a huge portion of their value was acquired through public money, not pension contributions. The GEPF was formed in 1996, bringing together a multitude of pension funds into one scheme. The largest of these, the Government Service Pension Fund, made the transition from a "pay as you go" to a fully-funded scheme in 1989. This move required massive government contributions in order to match the consequent funding shortfall, the majority of which was acquired through the sale of government bonds to the government-owned PIC. Thus, the value of GEPF assets cannot be simply described as "pensioners' money", as it has often been portrayed in the media.

Another important factor informing AIDC's proposal is the fact that the PIC is currently a locus of corruption and a potential site of state capture. AIDC has identified two root causes for this: First, the fact that the PIC and GEPF are heavily geared towards investment in corporate equity

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[1] Number arrived at by taking the GEPF's current funding level, 108%, to the rating agencies' 60% requirement.

incentivises corruption. While these investments may have provided larger returns, they also opened the door to corruption through, for example, beneficial relationships between PIC managers and those in the corporations that the PIC chose to invest in, or through shady investments in unlisted shares that are hard to investigate. For this reason, AIDC suggests shifting of some GEPF assets into government bonds to not only mitigate the Eskom debt crisis, but also help curb corruption. The second root cause is that the structure of the PIC is somewhat opaque and its investment decisions are difficult to track. This will have to be addressed through a reform of the PIC's governance and structure to ensure greater transparency and accountability.

What should we do with the PIC and GEPF?

Eskom, radical economic transformation, and a South African Sovereign Wealth Fund:

The most pressing task for the GEPF lies is in dealing with the Eskom debt crisis. AIDC research has found multiple viable alternatives for using the GEPF in this way. One of the simplest alternatives would be for the GEPF to take a so-called "haircut" on its R87 billion interest-bearing claim that it already has on Eskom, forfeiting the R8 billion in interest that Eskom owes it and thereby converting its claim to an interest-free loan.

Another would be for the GEPF/PIC to actually provide Eskom with a large, interest-free or low-interest loan to be paid back when Eskom is able to. This measure would provide Eskom with the crucial debt relief needed to pay its most pressing debts while avoiding the need for any austerity-measures or sales of Eskom assets. It is worth reiterating that the GEPF's vast surplus means that none of this will place pensions in any danger.

However, the use of the PIC and GEPF should not be limited to bailing out Eskom. While Eskom may be our most pressing crisis, it is far from the extent of our problems. The South African economy is stuck in a miserable trap of low-growth and unemployment. Successive governments have failed to transform it from its Apartheid structure: it remains extractivist, static, and unequal. Following the proposal to turn the GEPF into a pay-as-you-go scheme and "underfunding" it by 48% will free up more than R800 billion to be reallocated. This gives us a unique opportunity that goes far beyond merely saving Eskom from its debt burden.

To this end, AIDC suggests that the mandate of the GEPF be reformed to that of a Sovereign Wealth Fund (SWF). An SWF capitalised with R800 billion from the GEPF could be put to great strategic use as a motor for creative long-term economic development plans. The potential uses for this fund would be diverse, but AIDC has identified some key areas where a reformed GEPF could be put to use.

The ever-worsening impact of climate change has made a low-carbon development path a matter of urgency. AIDC sees the GEPF/SWF as playing a key role in not only making a 'just transition' to green energy, but also in funding the greater socioeconomic development needed to mitigate and adapt to climate change. This includes a transition away from an extractivist economic structure and towards the development of domestic manufacturing and agriculture, especially in the coastal regions. This kind of economic diversification could clear a path out of our low-growth and low-wage economic trap. The GEPF/SWF also has the potential to fund the widespread development of local infrastructure through strategic investments. This is especially pertinent for smaller local projects which otherwise face difficulty in attracting investors.

Finally, we recognise that there is reason to be wary of the potential for corruption to derail large spending projects such as those detailed above. For this reason, our research emphasises that a reform of the PIC's mandate has to go hand-in-hand with a structural reform towards greater accountability and transparency. Some key elements of this reform should include reductions in the salaries of officials from the PIC and other state entities, regular public reports on the PIC’s management and investments, and ensuring that development funds from the GEPF/SWF be channelled through efficient and corruption-free entities.