



**THE PUBLIC  
INVESTMENT  
CORPORATION &  
FINANCING A JUST  
TRANSITION**

**BY**

**ALTERNATIVE INFORMATION & DEVELOPMENT CENTRE**

# THE PIC, ESKOM DEBT & FINANCING A JUST ENERGY TRANSITION

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## Introduction

The Public Investment Corporation (PIC) is the asset manager for the Government Employees Pension Fund (GEPF) and holder of large sums of public assets. Thinking creatively about PIC can be the key to fixing the debt problem at Eskom and other State Owned Enterprises (SOEs) (Chapter 3). This booklet also looks at unlocking investment for job creation and at combating deepening austerity (Chapter 4). The final chapter (5) looks at governance in the context of widespread and deep corruption. The booklet illustrates how the PIC and the GEPF could be a means to address all of these issues simultaneously.

South Africa's growing public debt is being used as a means to legitimise deepening austerity without seriously questioning if it is true that the debt is not manageable, or whether it can be managed differently. Here, we need to interrogate the relationship between the government owned PIC and the government debt.

In July 2019, the Minister of Finance, Tito Mboweni, announced that the government will introduce a Special Appropriation Bill (SAB) to bailout Eskom, taking R59 billion from the national budget over the 2019/20 and 2020/21 budget years. The Bill was finally approved in October, with a commitment to continue servicing Eskom's debt for ten years. A total of R105 billion has already been taken from the National Revenue Fund to support Eskom's debt service.

Whilst the need to bailout Eskom seems to be unavoidable, tapping into the government's budget has resulted in the deepening of the austerity agenda. The budget cuts will especially negatively impact public service delivery like education and health for example.

We argue that the national budget **must not be used** to support looted and indebted State Owned Enterprises (SOEs). Instead, Eskom should be rescued by using the surplus resources of the GEPF, which the PIC is managing. A loan at zero percent or below market interest rates - coupled with conditions on how to transform Eskom - would shift GEPF's investments away from shares and into bonds specifically made to

deal with the SOE debt crisis. This is critical to saving Eskom (and other SOEs) and South Africa from more austerity and privatisation.<sup>1</sup>

**In Chapter 4 of this booklet we show that such a move will not put state employed workers' pensions at risk.** Firstly, the GEPF's pension scheme is a *defined benefit*, which means that the employer guarantees pension payments. Secondly, contributions and income from investments are guaranteed (*as it has been since its early years in the late 1990s*) to exceed pension pay-outs *even if* the GEPF uses some of its vast financial resources to save Eskom. Lastly, greater investment in the real economy through the PIC will ensure the potential for massive job creation, as we argue below. This will also reinforce the contributions to the pension fund, thereby additionally securing pensions for future government retirees.

The hearings at the Zondo Commission have made it clear that we cannot separate the current crisis at PIC and state owned enterprises from the problem of corruption. We cannot attribute corruption to a few bad individuals only. Instead, we have to understand corruption in relation to the prioritisation of a narrow class project and a regime of accumulation aimed at the development of what former President Thabo Mbeki called "the black bourgeoisie".

Many in the new political elite who came into power post-94 wanted to join the existing capitalist class as rulers of the economy. The problem they faced as would-be capitalists was that they had no capital. Their solution lay in using their political power to overcome this. Access to the enormous State and SOE budgets, whether legitimate or corrupt, was an obvious starting point. In recent years, the illegitimate use of state funds has become an increasingly common avenue for self-enrichment. Consider, for instance, the R62.60-billion lost last year (2018) by the State's 'irregular expenditure' or the unauthorised expenditure of R1.365-billion. We have come to know this phenomenon as State Capture; a cancer deeply and widely embedded in our entire political economy.

This is why changing politicians and managers and prosecuting individuals is not enough. We need to transform these state structures and institutions to serve the interests of the majority. Here, the role of organised workers is key.

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<sup>1</sup> This is elaborated in the Alternative Information & Development Centre's research "*Transform Eskom: A public sector path to renewable energy*". To get a copy email Sandra Van Niekerk [sandra@climatejobs.org.za](mailto:sandra@climatejobs.org.za)

## Chapter 1: The GEPF's shift from a pay-as-you-go

### (PAYG) scheme to fully funded one

In 1989 the Apartheid government made shifts in the functioning of the Government Services Pension Fund - which later became the Government Employees Pension Fund (GEPF) in 1996 - and its counterpart, the PIC, by shifting the pension fund from a Pay As You Go (PAYG) scheme towards a so-called "fully-funded" scheme. The PAYG scheme means that the pension contributions from those currently working pay for the pensions of those who have retired. This system works if the current contributions (i.e. contributions made by those who are currently working) are more than what must be paid to the pensioners.

In this system, not much is accumulated in reserves because the monthly contribution of workers will approximately match that of what is paid to pensioners. This is a tried and tested scheme worldwide. Often put in place by labour governments in the 1950s and 1960s, PAYG used to be standard policy for state pension schemes. Under this scheme, surpluses built buffer funds as protection against shocks, as well as financed investments in social infrastructure.

In comparison, the fully-funded scheme is required to have sufficient assets to meet all of its liabilities were members, both current workers and pensioners, to demand their full pay-outs at the same time. Private pension funds are usually required to be "fully funded", or have a high level of funding for all present and future liabilities to its members. This is to ensure that the scheme has reserves that protect pensioners and current contributors from the risk of the private pension fund going bankrupt. This risk doesn't apply to the GEPF because, as a public sector scheme, its liabilities are guaranteed by the Government.

The so-called "Pay-as-you-go" (PAYG) pension system uses the fact that no pension scheme has to pay all it owes its members at any one time. It works on the basis that, every month, "My pension is, because others' contributions are". Pension liabilities are paid bit by bit over a time span of 30-50 years.

The move to a 'fully-funded' scheme came about as a result of the negotiated settlement between the ANC and the outgoing apartheid government. The apartheid government insisted on guarantees that the government pension fund would be large enough to meet the demands of all members in the large security cluster of the apartheid government as well as senior state officials, including Members of Parliament (MPs), judges and director generals. In order to finance these demands, the government had to pump large amounts of public money into the pension fund. It did this by selling government bonds to the government owned PIC; i.e. taking loans from PIC that from 1996 onwards managed such bond-loans on behalf of the new GEPPF.

These loans, in the form of bonds, funded the large pension contributions to the GEPPF. In terms of its ability to pay pension benefits every month, the GEPPF soon became hugely overfunded. In addition to paying contributions to the GEPPF, the government has had to pay the PIC (i.e. to itself, because it owns the PIC) interest on these bonds, thereby artificially increasing the government's debt burden.

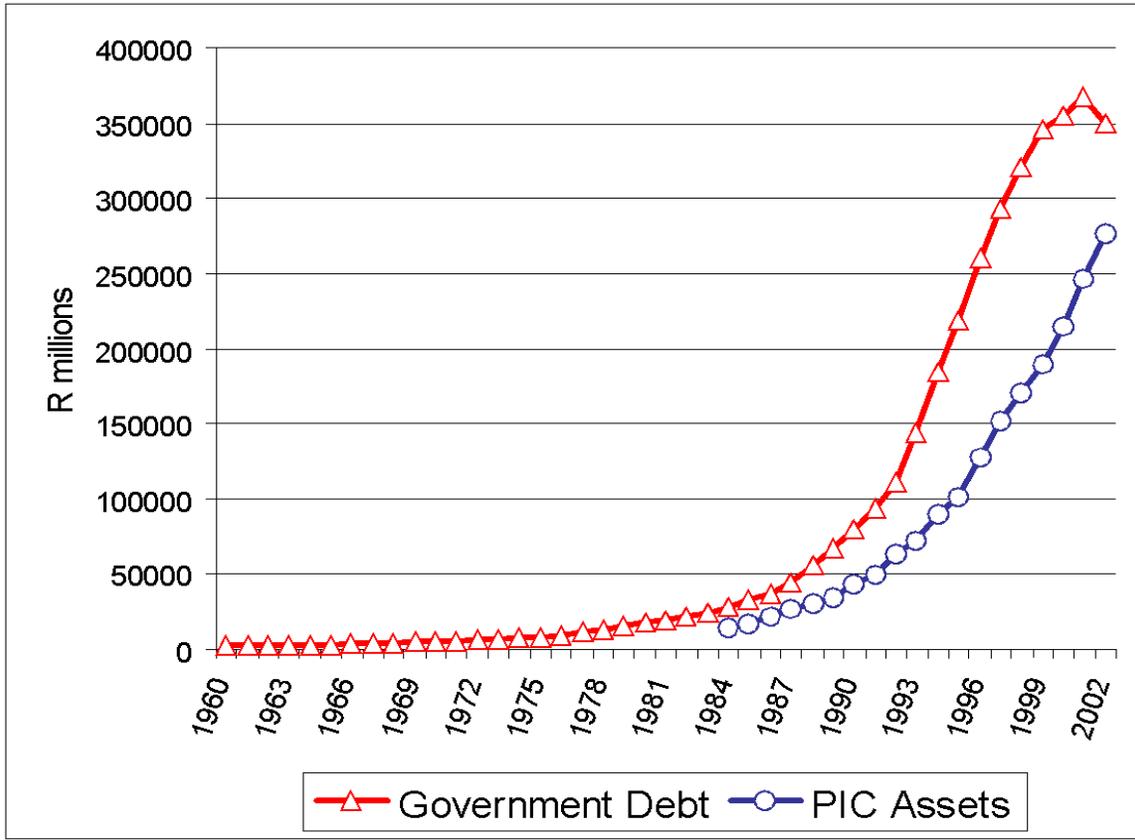
Between 1989 and 1996 the government's debt more than tripled from R80bn to R300bn. Almost half of this amount was attributed to the growth in public pension fund assets, which increased by R105 billion over the same period, especially after 1994, with the bulk of the assets being government bonds.

### **Figure 1: The Growth of Public Debt and PIC financial assets (1960 - 2002)**

*Figure1 (Below): The PIC's assets did not grow appreciably until the late eighties when the negotiation of how to end apartheid took place. At the same time a sudden and matching acceleration of public debt occurred. The assets of PIC were mainly an investment in government bonds.)<sup>2</sup>*

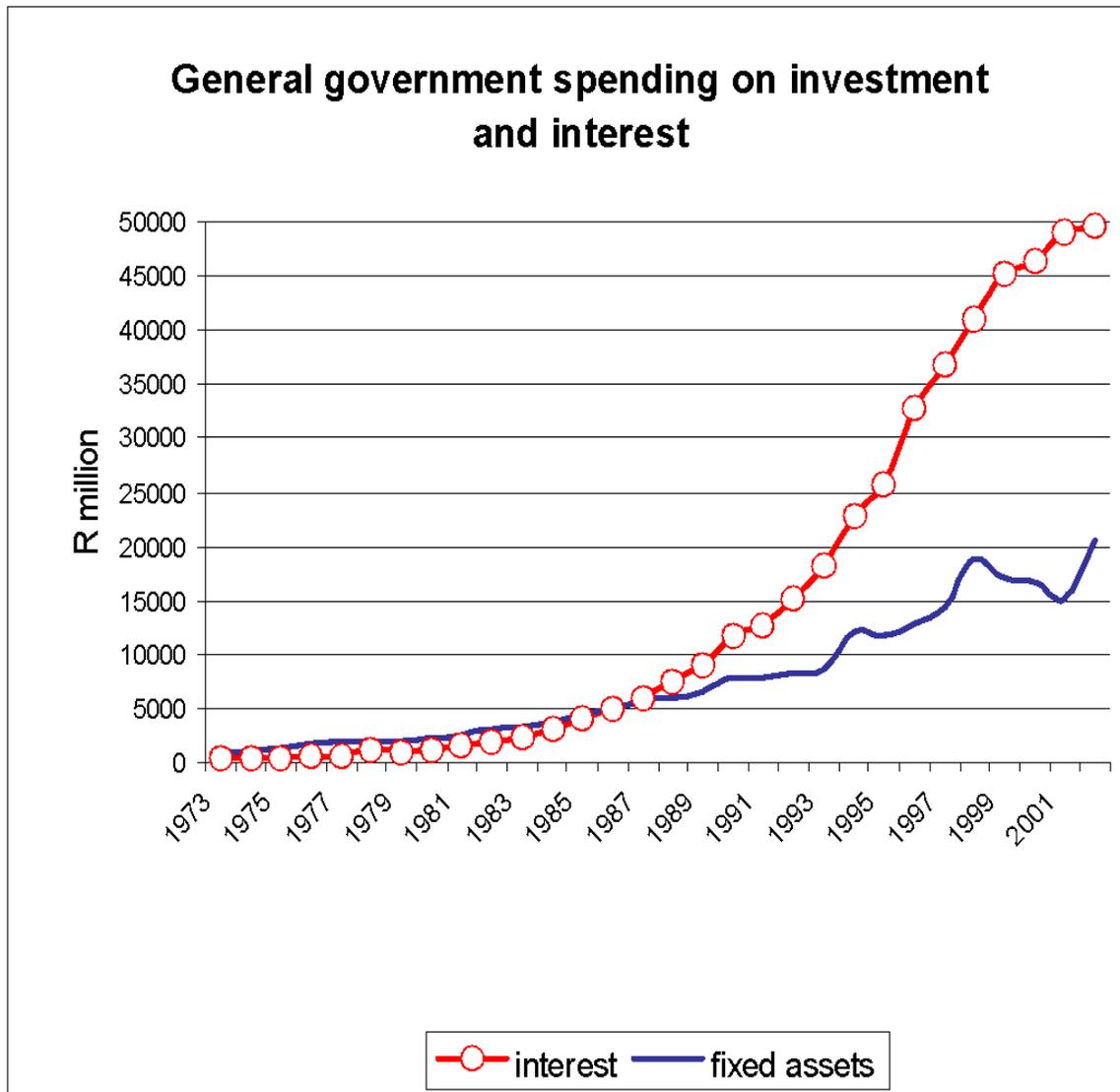
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<sup>2</sup> Duffy, G. (2003) Economic Impact of SA Debt Restructuring Revisited (Available upon request)



As a result, public spending on social services and capital investment was restricted as illustrated in Figure 2 below.

**Figure 2: Government Capital Spending and Interest Payments on debt (1973-2002).**



*Figure 2 (Above) shows government interest payments and capital spending up until 2002, illustrating the start of the bloating of the PIC. Given that the majority of the debt was in domestic currency and that some of it could have been written off as odious debt. Therefore, prioritising debt service costs over social investment was done voluntarily by the SA government without any pressure from the World Bank or the International Monetary Fund (IMF). This underlies the adoption of “Growth Employment and Redistribution” (GEAR), in 1996. Effectively the implementation of a home-grown structural adjustment program resulting in the curtailing of public services.*

## **Government Employees Pension Fund (GEPF)**

The GEPF was established around the same time as the adoption of GEAR (1 May 1996).<sup>3</sup> The fund brought together 10 separate pension funds for civil servants that existed before 1994, including funds from the former 'bantustans' - the main fund being the Government Service Pension Fund.

The demand on GEPF to become a fully-funded scheme meant that the GEPF began to accumulate a huge surplus. As of March 2018, the GEPF was estimated to have accumulated R1.8 trillion in assets, the equivalent of 108% of its present and future liabilities were funded.

In addition, a fund of financial wealth comprised of bonds and shares traded on the markets is dangerous and illusory, regardless of its size. The value of such assets is a so called "market value". The proportion of funds invested in corporate shares becomes a crucial question, as market value is dependent on economic activity, the expectation of traders of future profits and even on true reports to all shareholders by those running the companies. In a moment of economic crisis, funds comprised mainly of shares (also called "equity") will shrink when traders sell them off. The value of some company shares can become close to or completely worthless due to a collapse of share prices. For instance, the 2009 financial crash resulted in the market value of GEPF funds falling by over 10%.

In contrast to these equity-based funds, a corporate bond is an asset that stands first in line to be paid if the corporation is in trouble. A government bond – a loan to a government – is regarded as even safer, because of the government having the right to tax the citizens and corporations to pay its debts.

Before the world wide adoption of "neo-liberal" economic policies, state pension funds were in fact not allowed to invest in company shares at all. They held all their financial assets in bonds, which were for the most part secure government bonds. A second reason for this was that surpluses, in what were then usually PAYG schemes, were used for long term social investments like housing programs or infrastructure like roads, water supply and sewage systems, or state owned electricity power stations. In other words, the government or public companies were the ones who borrowed money from

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<sup>3</sup> [http://www.gepf.gov.za/index.php/about\\_us/article/who-is-gepf](http://www.gepf.gov.za/index.php/about_us/article/who-is-gepf)

the pension scheme; money that was not immediately needed to pay pensions from year to year.

### **What are the official public reasons for the shift?**

While appeasing the outgoing senior apartheid officials was the real reason for the shift, the 'publicly-stated' reason was in keeping with the explanations given in other countries, where such shifts from PAYG schemes to "fully funded" schemes were also taking place.

At the time, the public argument was that future demographic changes would endanger the sustainability of a pay-as-you-go system, for example, a situation where there are fewer workers and more pensioners would upset the balance of contribution to withdrawal needed to maintain a pay-as-you-go scheme. Such arguments have been contested: The most obvious rebuttal being that one can always raise contributions a little to keep the PAYG system going, if people live longer. Members will not notice this because the economy and their wages are expected to grow fast enough to cover the additional contributions. If needed, one could even increase the number of years people must work before they retire. It is only the neoliberal aversion against a slightly higher individual contribution that prevents such simple measures.

In contrast to the demographic changes in the so-called developed world, the South African population is very young and growing. Even with growing unemployment, wages and salaries of state employees have been growing above inflation. These increases have been financed by regular productivity gains in the whole economy. The gains have, in turn, increased the amount of taxes paid to the state, even though, for a variety of reasons, revenue collection has recently not been growing like before. The demographic argument against a PAYG system therefore has little relevance to our current context.

Regardless, the move to a fully-funded scheme came about as a result of a secret deal between the new government and the departing apartheid government which wanted to protect the pensions of state officials, as well as to provide funds for generous retirement packages and golden handshakes from the post-apartheid state.<sup>4</sup> The move was not, and cannot, be justified in terms of economic arguments against PAYG.

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<sup>4</sup> Duffy, G. (1997) Economic Impact of SA Debt Restructuring (available on request).

### **The workings of the PIC:**

Every year the GEPF hands over all of its income to the PIC. The PIC then invests the money, acting as an asset manager for the GEPF. 87% of the total assets managed by the PIC belongs to the GEPF, with a further 8% belonging to the Unemployed Insurance Fund (UIF).

It might come as a surprise to some that UIF is running a surplus every year in times of mass unemployment. At present this annual surplus is over R9 billion. The UIF has accumulated assets of around R170 billion, which the PIC invests in shares and bonds.

The PIC – like all SOEs which are sometimes still described as having been nationalised – is owned by a ‘shareholder’(!), the South African Government. In this particular case, the Minister of Finance is the ‘shareholder’s’ representative. In 2005, the PIC was corporatised in accordance with the Public Investment Corporation Act of 2004. Thus, even though the PIC is formally publicly owned, it operates in a manner comparable with any private sector asset manager.

This leads to a number of contradictions. For example, its commitment to guaranteeing good returns on investment for its ‘clients’ – the GEPF and the UIF – could conflict with its contribution to broader socio-economic development. In fact, there is reason to believe that the PIC has made investments that have been to the detriment of most South Africans. There is very little evidence that the PIC meets its obligations to ensure the “highest standards of corporate governance and investment accountability”, particularly given how difficult it is to obtain information about its investments. Consequently, the PIC has been under investigation for patronage and corruption, since January 2018.

### **The Government debt and the PIC:**

Effectively, the PIC gets most of its capital from another state organ, the GEPF. In the 2019 financial year, state employees and the government will pay about R80 billion in contributions to the GEPF, which will be handed over to the PIC for investing. In addition, some R45-R50 billion will be paid directly to PIC from the government, municipalities and State Owned Enterprises like Eskom, as interest on loans held in the form of bonds.

The PIC is a statutory body. This means it is a part of the government. The government is the only shareholder in PIC via the Department of Finance (the Treasury). The same is the case of the GEPE. Eskom's and other SOEs only shareholder is the government via the Department of Public Enterprises. When loans are given and paid back with interest from and to the PIC, it is the government having debt to itself and claims on itself, both paying and earning interest on loans: to itself and from itself.

## Chapter 2: PIC - The Financing of a Black Capitalist Class

### From RDP to GEAR: Building a black capitalist class:

The ANC's priority, since shortly after coming to power, has been to develop what Thabo Mbeki called a black capitalist class (or black bourgeoisie) in order to "*deracialise the ownership of productive property in our country*" (Mbeki, 1999)<sup>5</sup>. The prioritisation of the development of a black capitalist class, as will be elaborated below, meant the abandonment of the Reconstruction and Development Programme (RDP) and reducing to an optional extra any possibility of redistributing wealth to the majority of South Africans.<sup>6</sup>

As previously alluded to, the black political elite, the would-be capitalists, had to confront the reality that apartheid had left most of them poor. Their immediate challenge was therefore: How to become capitalists without capital? The development of this aspirant capitalist class therefore needed: (1) a state-directed requirement for Black Economic Empowerment (BEE) and (2) the use of SOEs as a means of accessing capital.

One of the major reasons given by the ANC for not following through with the more redistributive RDP was because of the government's claim that it needs to repay the apartheid debt. However, the overwhelming proportion of the debt was what the government owes itself, namely the PIC. Only part of the debt was linked to apartheid inherited debt, which, in any event, the post-apartheid government was well placed to

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<sup>5</sup> Thabo Mbeki's speech in 1999 at the Annual National Conference of the Black Management Forum Kempton Park. URL: <https://www.sahistory.org.za/archive/speech-annual-national-conference-black-management-forum-kempton-park-november-20-1999>

<sup>6</sup> URL: [ANC's past policies worth revisiting](#)

refuse to repay under the Doctrine of Odious Debt.<sup>7</sup> The bigger share of debt came, as we have seen, from the shift in the Government Employees Pension Fund from a pay-as-you-go scheme to a so called “fully-funded” one.<sup>8</sup>

The GEPF, as the major client of the PIC, is important for a second reason. In relation to the state being used as a means to accumulate wealth for the black bourgeoisie – an emerging new faction of the capitalist class – the link between state-owned enterprises (SOEs), corruption and cronyism is often made. But one of the most obvious of instruments for this is the PIC, the largest asset manager in Africa, that happens to be controlled by the government.<sup>9</sup>

The fact that the PIC manages mostly workers’ money is ironic given the frequency with which it has acted against the interest of these workers. A well-known, early example of this is when the PIC, headed by Brian Molefe, financed privatisation by enabling the black investor group – Elephant Consortium – to buy private equity from Telkom.<sup>10</sup>

More recently, the still ongoing State Capture inquiry and the concluded Public Investment Corporation Commission of Inquiry, has brought PIC investments and management under scrutiny. This includes allegations against four of the PIC’s executive directors, one of whom was the Deputy Minister of Finance - Mondli Gungubele.

### **PIC: A site for cronyism and corruption?**

The aspirant black elite’s strategy of capital accumulation through the use of the PIC took two main forms: illegal and corrupt deals and BEE investment schemes.

Under Mbeki, the early capture of capital by a tiny number of well-placed individuals took place. BEE was the main instrument used to legitimise the use of pensioners’ money to create this new black stratum within the capitalist class.

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<sup>7</sup> URL: <http://www.cadtm.org/The-Doctrine-of-Odious-Debt-from> In simplified terms, ‘odious debt’ means debt from loans to a government that without any doubt used the money against the public interest, like financing repression against a liberation movement and wars, like SA participating in the war in Angola.

<sup>8</sup> URL: <https://mg.co.za/article/1997-12-12-dont-repay-unjust-debts>

<sup>9</sup> URL: [GEPF Annual Review \(2017-2018\)](#)

<sup>10</sup> URL: <https://mg.co.za/article/2005-05-06-elephant-consortium-acquires-stake-in-telkom>

Under Zuma, corruption and cronyism has been the main source of capital accumulation for his favoured cronies (who duly became his support base in his battle with Ramaphosa). In the PIC, this was facilitated through mutually beneficial relationships between those on the PIC governance structure and the corporations that the PIC invests in. An example of this would seem to be the funding of the Lebashe Investment Group. One of the non-executive directors of Lebashe is Jabu Moleketi, who, as the then Deputy Finance Minister, was also chair of the PIC.<sup>11</sup>

### **Unlisted Shares: A major channel for primary accumulation:**

One of the main avenues for primary accumulation was through PIC's purchasing of unlisted companies. Unlisted Companies are those not registered on the JSE. Unlisted companies (such as VBS Mutual Bank, in which PICs had an unlisted 25% stake) are not well regulated. Such shares are therefore riskier than listed companies.

Since investments in unlisted shares are difficult to track, they are more likely to be influenced by political affiliations such as connections between BEE companies and members of the political elite.<sup>12</sup> According to the GEPF's 2018 annual report, its investments in unlisted companies increased by 37% since 2017, or from R36.9 billion to R50.7 billion, partly as a result of revaluation of previous investments but also because of new investments.<sup>13</sup>

Dr Dan Matijila, former CEO of the PIC, justified investing in unlisted shares as fostering transformation and inclusive growth,<sup>14</sup> but it seems that its main result is to enable and encourage corruption. Unsurprisingly, Matijila says nothing about the corruption facilitated by unlisted shares. The calls by Abel Sithole, the GEPF's current Principal Executive Officer, to double investment in unlisted shares should come with warning bells.<sup>15</sup> Notwithstanding what could be Sithole's reversal of these calls, an important measure to put an end to corruption in the PIC would be to support the demand by the GEPF to have unlisted investments suspended, at least until the end of the PIC Commission of Inquiry.<sup>16</sup>

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<sup>11</sup> URL: [Holomisa claims 'hurtful, damaging', ex-deputy finance minister Jabu Moleketi tells PIC inquiry](#)

<sup>12</sup> URL: [Magda Wierzycka: Unpacking PIC whistle blower's document which names the plunderers](#)

<sup>13</sup> GEPF, 2018 Annual Report, page 8.

<sup>14</sup> URL: [PIC CEO Dan Matijila pens an open letter to South Africa](#)

<sup>15</sup> URL: [State pension fund wants to double its unlisted investments](#)

<sup>16</sup> URL: [Magda Wierzycka: Unpacking PIC whistle blower's document which names the plunderers](#)

### **Corruption - a political and economic project:**

All of this makes it clear that the post-1994 economic path, the development of a black capitalist class and the parallel rise of corruption, are closely intertwined. Black Economic Empowerment is now seemingly being replaced by a new buzzword – “transformation” – aimed at legalising and legitimising the predatory practices of the “black bourgeoisie”. The PIC has been involved in both cases, BEE and the predatory-cronyism that follows.

### **The GEPP and the PIC needs to be reformed:**

The PIC Commission of Inquiry is critical in revealing corruption and mismanagement at the PIC. Naming-and-Shaming is an important short-term measure that hopefully results in punitive action being taken against the guilty parties. However, greater structural transformation is required in order to mitigate against similar corrupt practices in the future. Moreover, reforming the PIC, as suggested below, will mean that it will no longer serve a narrow class project but instead can lead to a genuine transformation that includes the majority of South Africans, unlike BEE, which mainly is a minority project even when scandal free. Mass economic empowerment – such as is possible within an economy that produces poverty and inequality along with wealth – is what is needed. To that end, both higher wages to workers at the expense of profits and a stronger public service delivery sector backed by a state that is not corrupted by schemes for private enrichment are essential requirements.

## **Chapter 3: Current State of the PIC and GEPP**

In August 2019, Finance Minister Mboweni announced a Special Appropriation Bill which awarded Eskom an extra R59 billion over two years. The budget of the government will now finance even higher debt service costs.<sup>17</sup>

There is an absurd aspect to this appropriation. Why is the Finance Minister Mboweni not negotiating debt relief with a creditor that is in fact an organ of the state? The same irrationality applies to the February 2019 announcement that the Treasury allocated R69-billion from the national budget over three years to Eskom’s debt service.

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<sup>17</sup> This is an edited version of an article published in Daily Maverick, August 2019.

Arguably, this allocation is also unconstitutional, given that the government's constitutional mandate is to gradually improve the lives of all “within its available resources”.

### **Is there another way?**

In the 2017/18 fiscal year, the government paid an estimated R25-billion in interest on its R359-billion debt to the GEPF. This R359-billion loan claim on the government was, at that point, 14% of the government's gross debt. In addition, Eskom's debt to the GEPF in March 2018 was R87-billion. This was 20.8% of Eskom's total R419-billion debt in 2018. The GEPF probably earned a market rate interest of some R6-billion on this investment because of Eskom's low credit rating. In this way, at least 45% of the GEPF's R72-billion cash income from investments in 2017/18 came from either the government itself or from the state-owned Eskom.

**The crucial question is whether the GEPF actually needs these income streams to pay the required pensions and benefits?**

The Government Employee Pension Law of 1996 (GEP Law) requires the funds of GEPF to cover 90% of all liabilities at any point in time. The actuarial audit of GEPF concluded that on 31 March 2018, the GEPF had R1,802-billion in financial assets managed by PIC. It covered 108% of GEPF's liabilities to working and retired members.

This means the market value of GEPF's financial assets could have been R304-billion less in March 2018. It would still have met the 90% legal requirement. At a 100% funding of liabilities, which is the political goal of the board, the surplus was R137-billion.

**Now, why does the law stipulate a mere 90% “funding level”? Mustn't all pension obligations be paid?**

They have to be paid, but, as already noted, not all of them on the same day.

The statutory audit controls of the market value of the fund's financial assets must always be enough to pay “the present value” of past and estimated future liabilities to those who are members and until they die. If it is, then the scheme is 100% fully funded.

The “funded” pension scheme must have all the money in advance to be “100% fully funded”. It works similar to a well-paid but lonely individual who calculates how much they should save until the day they stop working, and who will then start withdrawing money from an interest bearing account until they die.

But no matter how it is constructed, no pension scheme is actually paying the theoretical “present value” of all present and future liabilities to those who are members on a certain day. In this world, it never requires that theoretical “100% coverage”.

This is why South Africa’s GEP Law can set the minimum to 90% funding “in advance” of liabilities and why, for example, the legal demand on the funding level of a private pension scheme in the US is put at 80%, or why the credit rating agencies Standard & Poor, or Fitch, regard a funding level as “weak” only if the funding level is below 60% in a public pension scheme like GEPF.<sup>18</sup> The “underfunding” allowed for in the GEP Law is a kind of concession to the practical power of an “unfunded” pay-as-you-go scheme.

In the case of the GEPF, the potential power of a PAYG scheme has been boosted with large cash flows from dividends and interest on investments. For fourteen years, from 1998 to 2013, investment cash flows were not touched to pay benefits. They were all reinvested by PIC. Contributions were equal to or higher than benefits paid. The contribution surpluses were also invested. The result was the exponential growth of GEPF’s financial assets, interrupted only by the stock market crash 2008-2009.

For this reason, finance ministers and GEPF boards have never followed the auditors’ recommendations to increase the employer contribution rate. The 2018 audit had the same recommendation, but the level stayed at 16% on salary for service staff and 13% for all others, giving an average of 13.5% in employer contribution. In many private pension schemes 7.5%, is the norm that is deducted from the salaries of the employees.

A generous rule change, from 1 April 2012, let members withdraw their whole “actuarial interest” share in the GEPF if they resigned before retirement day, instead of using a defined benefit formula for early resignations unrelated to developments on the capital markets.

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<sup>18</sup> URL (2019-10-28):

[https://www.nasra.org/files/Topical%20Reports/Funding%20Policies/80\\_percent\\_funding\\_threshold.pdf](https://www.nasra.org/files/Topical%20Reports/Funding%20Policies/80_percent_funding_threshold.pdf)

The change led to mass resignations that were encouraged by the finance industry; the expectation of course being that the lump sums would be moved to private schemes to attract hefty fees. In response to this, an eyewitness tells us that Finance Minister Pravin Gordhan pleaded with delegates at Fedusa's 2013 wage bargaining conference to start a campaign for members not to leave the GEPF.

<i>Billions of rand</i>	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.

**Table 1: Cash Flow Account for GEPF Finances in R, (2017-2019)**

Despite these mass-resignations, benefits paid doubled from R43.2-billion in 2012/13 to R85.8-billion in 2014/15 (stabilising at that level). A portion of cash flow from dividends and interest received, had to be used to pay benefits from 2013/14, as benefits paid exceeded contributions received for the first time since 1998.

The incident demonstrated the healthy state of the fund even when hit by shocks, like unintended consequences of policy changes. The contribution rates remained unchanged. Even after all this, the GEPF's cash income surplus in the 2018 fiscal year was R47.5-billion. There were no additional payments from the government to deal with the shock.

The Eskom crisis, and the huge impact Eskom's collapse would have for all of us, requires serious consideration of alternatives.

In times of debt crisis for governments, private creditors have often been offered a so-called “haircut” rather than facing the risk of losing all their claims. A “haircut” can mean getting a lower interest on a loan. A plethora of more or less radical options are also available:.. Alternatives can range from simply writing off the debts to delaying the payback. Converting ordinary bonds into “zero-coupon bonds” has been suggested by Magda Wierzycka: The loan, and the interest on it, is paid only when the loan period expires.<sup>19</sup>

As it stands, GEPF can take a haircut of its R87-billion bond claim on Eskom with no risk to the guaranteed pension payments. It can forfeit some R6-billion in interest income from its Eskom bonds, converting the bonds to an interest-free loan. The Treasury’s instruction to departments before the Mid-Term Budget to cut spending by 16% over three years is what should alarm the public, particularly, the over one million public sector employees, their unions, and their representatives on the GEPF board.

#### **GEPF’s so called funding ‘short-fall’**

Early in 2019, concerns were expressed about the GEPF’s alleged “long-term funding shortfall” of R573-billion. The main reason for what is essentially a technical, actuarial, shortfall is GEPF’s needlessly risky investment policy. With over 50% of the funds placed in equity, the solvency fund, which guards against financial crashes, is inadequate, being filled only to a third. Moreover, this risk should compel a shift in investment priority from equity to government bonds, which should be bought by GEPF at regulated interest rates.

If the GEPF board would shift half of its over R1-trillion investments in company shares into secure government bonds, the theoretical “shortfall” would fall drastically. There would no longer be a need for a R403-billion solvency fund (which increased by R100-billion in 2018 compared to the 2016 actuarial audit).

The R573 billion is a theoretical number. It is what the auditors “would like” the GEPF to have, to finance additional benefit goals decided by the Board, like future pension increases above inflation. The main part of it is in fact a demand for this larger solvency

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<sup>19</sup> URL:

<https://www.businesslive.co.za/bd/opinion/columnists/2019-01-17-magda-wierzycka-zero-coupon-bonds-a-n-elegant-solution-to-eskom-cash-crunch/> (2019-10-28).

fund. The auditors basically said that GEPF's investment policy is too risky: Too much of the GEPF funds are held in shares.

It can be added that there can be no counterpart in the South African economy to an additional R573-billion financial claim of GEPF. The total of all loans given in the economy is always equal to total debts. We would not like Eskom or other state owned enterprises to have R573-billion more in debts, to the GEPF or anyone else. And we don't want the market value of all shares traded on the Johannesburg Securities Exchange (JSE) to be R573-billion more. The JSE is already the most overvalued stock market in the world: about R15-trillion in total market value (June 2019) of all the traded shares compared to South Africa's Gross Domestic Product, which this year is a little more than R5-trillion.

There are already discussions among observers that a global stock market crash might be on its way. The most visible indicator is the high debts of large corporations. A lot of these debts are held by banks. If the banks become suspicious that other banks have given loans to corporations that will not be repaid, they will stop usual intra-bank lending. This can lead to a global crash, similar to what happened in 2007-2008.

Shifting half of the over R1-trillion of GEPF's shareholding into government bonds, would simply adopt the same investment policy as the Unemployment Insurance Fund UIF. UIF holds only 25% of its assets in company shares. GEPF right now has placed over 50% of its financial assets in shares. A shift in policy from shares to bonds would both deal with the debt crisis and secure the pensions of state employees.

## **Chapter 4: How the PIC can be used for an Expansionary Development Strategy**

### **Cancel the debt to free up budget resources:**

As explained previously, the GEPF is not only paying pensions and receiving large contributions from the national budget (about R80bn in the 2019/20 financial year). It has also become a massive investment fund managed by PIC. Some of GEPF's massive surpluses have also been redirected towards a tiny minority of politically connected persons, who rely on the perpetuation of apartheid's racial categories to justify their privileged use of these resources.

One of the ways in which this fund can be used to benefit the majority of South Africans is to use it in order to deal with government debt in a way that does not adversely impact the working class (which includes the poor).

Indeed, the GEPF is already a big creditor of the government. We have mentioned that by March 2018 it had lent R357 billion to the government budget, holding this interest bearing claim as Treasury bonds. For the 2019/2020 budget year, the government plans to spend as much as R202.2 billion in interest payments on its R3,043 billion gross debt.<sup>20</sup> R25-30 billion of this R202.2 billion will be paid to GEPF.<sup>21</sup>

The R202.2 billion represents 11.2% of the government's total expenses for the coming year! If this whole amount was redirected towards basic education, it would almost double the education budget instantly. Such amounts could also be used for housing, economic development or public health.

### **Converting a Public Pension Fund to a Sovereign Wealth Fund:**

Another option that would benefit the majority of South Africans is to transform the GEPF into a **Sovereign Wealth Fund (SWF)**, whose broad mandate is determined democratically with the ultimate objective of benefitting the country's economy and all its citizens.

Normally, such funds exist in oil-rich countries (Norway, Saudi Arabia, Alaska, etc.), mineral rich countries (Russia), or countries that benefit temporarily from an excess of foreign currency reserves (Singapore). The uses of such funds are very diverse. In some cases, they simply allow for the stabilisation of a country's revenue streams, but some countries use such funds more proactively: they build up savings for future generations (Norway), acquire strategic industrial companies (China) or diversify their economy (Saudi Arabia, Oman).

In fact, the GEPF can be considered a Sovereign Wealth Fund, albeit one with a very particular and narrow official mandate: to ensure that pensions will be paid no matter

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<sup>20</sup> The Treasury, 2019 Budget Review, pages 84 & 85: "Gross Debt" means total debt. "Net Debt" means "after deductions for your claims on others or assets". You can owe someone R100 but at the same time have a R50 claim on someone. Your gross debt is then R100, but your net debt is R100-R50=R50.

<sup>21</sup> This can be derived from the R356 billion that GEPF in 2018 held in government bonds and GEPF's cash flow statement in the 2018 Annual Report, page 68.

the circumstances . However, as demonstrated, the GEPF is over-funded for the purpose of paying pensions. This is far from a strategic use of the fund.

Shifting back to a PAYG pension system would allow us to redesign the role of the GEPF into that of a SWF whose mandate is to ensure the long-term sustainable economic development of South Africa. In other words, this would be a shift from a simple (bloated and misused) pension fund to a development fund. Already-public money, which has been paid into the scheme since the 1990s, and which is the source of its huge surplus, would thereby be put to proper public good.

For South Africa to simultaneously possess both a sizeable SWF *and* a sizeable public debt is an anomaly. By either deciding to cancel the debt or to reshape the GEPF into a broader SWF, South Africa will free up massive amounts of resources towards new long-term spending priorities. The next section will explore a few relevant possibilities for a SWF.

### **The future roles of the South Africa's Sovereign Wealth Fund:**

#### ***Diversify the economy***

A more strategic use of GEPF resources would be to channel the funds available away from the Johannesburg Stock Exchange (JSE) and to focus them on social investments and industrial development instead. The Industrial Development Corporation (IDC) appears to be an efficient institution that already supports nascent industries in South Africa. The IDC so far remains free from procurement or investment scandals. However, it needs to access more funding if South Africa wants to accelerate its shift from an economy based on mining extractivism to a productive and sovereign economy based on manufacturing and food production, especially in rural areas and coastal communities.

Currently, the funds available for the IDC are only R137 billion.<sup>22</sup> This can be compared to over R2.1 trillion placed in PIC (March 2019). As we have seen, almost 9 out of every 10 rands of the funds under PIC management belongs to the GEPF. Mobilising funds from the GEPF to slowly reinforce the capacity of the IDC can hasten our economic and social development.

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<sup>22</sup> Industrial Development Corporation, Integrated Report of 2018, p.1

### ***Plug our infrastructure gap***

Another essential issue for the South African economy is that it requires a huge amount of investment in infrastructure in order to grow meaningfully. By shifting the mandate of the GEPF to become a SWF that invests strategically, massive resources could be unlocked towards the funding of infrastructure projects whose returns on investments are both high and long-term. Such social infrastructure investments cover water, sanitation, clinics, local transport and housing; investments that improve the health and the lives of all. Economically, it would improve productivity and buying power through the creation of many jobs.

With minimal re-training, the slogan in social infrastructure projects should be: “**Employ People As They Are!**”, where government is the employer of last resort and people are employed to do things that they are already capable of doing or can be quickly trained to do.<sup>23</sup>

The difficulty of private investors to get quick money from these kinds of smaller local projects means that many infrastructure projects that could create social development and food security are not started. The policy norm of putting projects out on tender is also a source of high costs and corruption.

One institution, the Development Bank of Southern Africa (DBSA), is facilitating infrastructure development in domains such as large bulk water infrastructures, logistics and transportation, energy or telecommunications. Its budget is however also very low. The assets under its management in 2018 were as small as R89 billion.<sup>24</sup>

Channelling resources into the DBSA would be a proper “Marshall Plan” that South Africa could implement to get its economy out of its current stagnating state of mass unemployment, environmental destruction, water shortages and social deprivation.

It deserves to be repeated: Focusing on daily-life infrastructure would benefit the whole population of South Africa, leading to great improvements in general well-being. Increased productivity in the South African economy would be an additional spin-off from this.

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<sup>23</sup> URL: [http://www.levy.org/pubs/wp\\_515.pdf](http://www.levy.org/pubs/wp_515.pdf) (2019-10-28).

<sup>24</sup> Development Bank of Southern Africa, Integrated report 2017/18, p.4

### ***Lead South Africa on a path towards a just transition away from fossil fuels***

Another challenge for the South African economy is to be able to shift its productive capacities towards a sustainable low-carbon development path in order to stop climate change. This obviously means shifting away from coal power generation towards renewable energy, but it also requires the development of ambitious public transport systems in our cities and rural areas; the creation of a functioning national railway system, and the shift of our agricultural system towards more water-savvy and climate friendly low-scale farming methods, developing the food production in rural communities that are already taking place, and starting this in other communities where agriculture has declined, including in urban dwellings.

Climate change needs to be mitigated and resources will need to increasingly focus on making our communities more resilient, for instance by installing hundreds of thousands of water-saving devices.

These are only a few examples, but already these initiatives could create a massive number of jobs. To implement such a People and Needs Based, Climate-friendly, New Deal will require a substantial amount of resources<sup>25</sup>. Here the GEPF and the PIC can play a key role.

The potential of the accumulated funds of the GEPF are massive. The only requirement for their mobilization is a change in the mandate of the fund towards a broader SWF mandate, and to cancel or renegotiate the debt that State Owned Enterprises like Eskom and the government itself has, with itself, via the GEPF.

## **Chapter 5: Governance**

The PIC Commission of Inquiry underlined the critical need to improve publicly accountable governance and transparency.

A new Bill that suggests a number of changes to the Public Investment Corporation (PIC) Act is currently going through its Parliamentary process.

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<sup>25</sup> One Million Climate Jobs booklet, available at the Alternative Information & Development Centre (<http://www.aidc.org.za>)

The PIC Amendment Bill has been approved by the National Assembly and is now being referred to the National Council of Provinces. The Bill has a number of dimensions including new requirements for the fund to::

- Make investments that benefit depositors
- That it “must seek” to invest in projects that advance the developmental objectives of the country
- Submit a report to the Minister of Finance that will be tabled with the annual report and published on the PIC’s website, including full disclosure of all investments made (listed and unlisted).
- Submit detailed reports of all its requests made to the minister for approval

However, still greater structural transformation is required to mitigate against corrupt practices in the future. Our suggested additional changes to the Bill include the following:

1. *Shifting the Pension Fund back from Fully Funded Scheme to Pay-as-you go scheme*

By converting back from a fully funded scheme to first an under-funded scheme and then finally back to a PAYG scheme, huge sums of money could be freed up for social investment or the creation of a sovereign wealth fund. Doing this will not threaten the government employees pensions as long as contributions and the income of the current surplus of the pension fund is greater than the amount in pensions required to be paid out according to the relevant rules, and including the administrative cost of managing the fund.

We saw in Table 1 above (pg 17) that the GEPPF in 2018 ran with a R47.5 billion surplus after pensions and benefits had been paid, and a further R55 bn in 2019. Besides contributions, the cash flow incomes were R72 billion, R45 billion of which comprised an interest income from R576.7 billion held in government, corporate and SOE bonds. Almost two thirds of all bonds were SA Government bonds (R358.8 billion). A mere 5% cash investment income from R1 trillion in financial assets would today finance the government pension and benefit payments with about R25 billion in annual surplus, which again can be reinvested into the buffer fund. In this way a SWF could start with initial capital of R800 billion, if taking the 2018 financial year as the benchmark (when GEPPF’s funds were valued at R1.8 trillion).

## 2. Change in Mandate

The mandate of the PIC currently requires it to ensure both good returns on investment and to contribute positively to broader socio-economic development in society. These latter demands have not been adequately met. We recommend PIC's mandate be redrafted to fund long-term public investment that can drive a new industrialisation and social investment programme. Critically, boost productivity growth instead of focusing on short-term financial returns gained on the JSE. To do so, the fund should partner with existing efficient developmental financial institutions such as the Industrial Development Corporation (IDC) and the Development Bank of Southern Africa (DBSA). Another main part of its funds should be in government bonds and bonds in the crisis-ridden SOEs

## 3. A Shift to Transparency

In transforming the PIC, it is critical to ensure transparency and accountability to ensure that it is being used as an instrument for greater socio-economic development that benefits the majority of South Africans. This would entail publicly disclosing (with regular reports) exactly (1) how the PIC is managed, and (2) to whom, how much and under what conditions all investments are made.

It would also mean that the PIC can be used to demand transparency from corporations and their practices to ensure that corporations are also held to greater account. For example, the practice of letting nominees hold the shares of the true beneficiaries should be forbidden in the Companies Act, as suggested by the investigative journalists of *AmaBhungane*.

Finally, while the inclusion of trade union representation on the PIC board is an important first step, much greater worker control over the asset manager is critical. Excessive salaries salaries and perks for board members needs to be challenged, especially for union representatives who should be able to "survive" on the remuneration they have as office bearers. A drastic reduction of salaries and perks in state entities like PIC, UIF and GEPF must be put on the agenda as part of a broader effort tackling scandalous salaries in the public sector

This will, in essence, be the beginning of the "de-corporatisation" of PIC. Instead of what now passes for 'transformation', the PIC needs to be transformed into a truly public service entity guided by the ethos of contributing to meeting the public's most

basic needs with cheap (if not free), high quality, efficient and reliable services; services that are inherently inconsistent with profit maximisation.

Twenty-five years of democracy have preserved the wealth of the already privileged and opened the doors of privilege to a new elite. The material lives of everyone else have, at best, remained largely unchanged. PIC is very well placed to help finance the affirmative action of the hitherto forgotten majority.