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# Have our retirement funds been misallocated?

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To achieve a sustainable recovery in investment and growth, South Africa needs to mobilise patient capital on stable, affordable terms. However, in what has arguably been a substantial misallocation of capital, the country's collective savings have been systematically steered, over the past 20 years, towards equities and offshore investments at the expense of domestic government bonds.

By far the most important source of capital for the country is the savings of households in retirement funds and collective investment schemes (unit trusts). South African retirement funds held over R6.5 trillion in assets at the end of 2024. Life insurers manage at least a further R1 trillion in individual annuity products.

Funds under the management of South Africa's savings institutions have increased substantially over the past 40 years, rising from 47% of GDP to over 140%. Their contribution to financing domestic public debt has, however, almost halved from 80% in 2003 to 44% in 2023.

Whereas in most advanced countries the primary vehicles for financing pensions are contributory social security funds, largely invested in government securities, South Africa's retirement funding system relies on privately administered funds with contributions encouraged through tax incentives.

In the 1980s, pension funds were obliged by prescribed asset regulations to hold large shares of their investments in government and parastatal debt securities. Government pension funds were entirely invested in public sector debt.

The upshot was that by 1983, just under half of the consolidated assets of retirement funds, life insurers and collective investment schemes were invested in public sector securities. However, by 2003, following significant industry deregulation, this share had fallen to less than a quarter. In recent years, it has dropped to about 20%.

Even the Public Investment Corporation (PIC), which manages assets mainly on behalf of government pension funds, has reduced its holdings of public sector securities from over 80% of total assets in 1993 to less than one-third in recent years.

The change has been so marked that South Africa now has among the lowest proportion of bonds (as opposed to equities) in its pension fund investments, according to a cross-country comparison in the OECD's Pensions at a Glance report.

These shifts in investment patterns reflect a diversification towards equities and foreign assets in the decisions of fund managers against a background of regulatory liberalisation alongside diminished confidence in the country's growth prospects, fiscal dynamics and state-enterprise governance.

One might have expected that deregulation and diversification would have led to better returns than offered by government bonds. But the average return on investment achieved by privately administered retirement funds, as reported by the Financial Sector Conduct Authority for the 2014-2023 period, was *lower* than the average return on long-term government bonds.

The Government Employee Pension Fund's (GEPF's) 2024 annual report indicates that its portfolio return over the previous 10-year period was just 7.2%.

Over the past year, equity returns on the JSE have been high, but this has been offset in many funds by the impact of the stronger rand on foreign investments.

On a risk-adjusted basis, it is hard to avoid the conclusion that South African savings institutions are over-weight in equities and foreign assets relative to domestic public securities.

The flow-of-funds accounts published by the SA Reserve Bank support this conclusion. They show that whereas South Africa's public sector financing requirement remained high over the past decade, the domestic corporate sector has been a net contributor to savings over this period. And it has bought back shares or acquired foreign or domestic financial assets, rather than raising funds for capital investment purposes.

The domestic public sector financing requirement has been largely met by banks in recent years, in the absence of sufficient purchases of debt securities by non-bank financial intermediaries. But the result has been diminished bank funding of their core enterprise-lending and housing-development business.

Assessed in relation to South Africa's macro-financial circumstances, these trends have impacted adversely on domestic capital formation and fiscal sustainability:

- The inflation-adjusted cost to government of its debt has been higher than it would otherwise have been because domestic long-term savings have largely been invested elsewhere.
- While secondary market equity investments and foreign asset acquisitions contribute to portfolio diversification, they have little impact on capital formation by businesses.
- Private sector credit extension for investment purposes has been constrained by the take-up by banks of low-risk government securities.

- Financial institutions have held back from the kinds of engagement with public sector borrowers that could have contributed to better governance and financial discipline.

Of course, the allocation of capital to infrastructure and corporate investment has to follow (not lead) project plans, investment proposals and business fund-raising decisions. And, granted, institutional fund managers respond to investment opportunities after consideration of their perceptions of risk, policy coherence and future growth prospects.

However, while capital-allocation decisions may individually reflect rational risk-adjusted portfolio diversification, the collective outcome for the country as a whole can still be far from optimal.

The bottom line is that if domestic funding flows lean against public investment priorities that are critical to sustainable growth and development, capital formation and social progress will be held back.

Prescribed assets provided a crude mechanism for securing long-term funding for public investment in the 1980s. If this kind of dirigiste mobilisation of capital for public investment purposes is to be avoided in the 2020s, more deliberate and evidence-based forms of institutional cooperation must be found to ensure that the country's growth and development needs are financed in affordable and sustainable ways.

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