BIZCOMMUNITY

Are prescribed assets bad for the country?

By Ronald King

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The short answer is yes, but it is a little more complicated than that, as there could be benefits too. Contrary to popular perception, prescribed assets are not a process by which the government takes a portion of your retirement funds, which decreases the value. Instead, it is a mandatory requirement for an institution (most notably retirement funds, but the scope could be wider) to invest a stated percentage of their funds into specific assets. In most cases, these prescribed assets are likely to be loans to the government and state-owned enterprises (SOEs). The institution will still receive a return on its investment in the prescribed asset, and the investor could well receive a higher return than the return on any other asset. However, the risk is that the state or the SOE may be unable to repay the loan when it matures, and then the investment is lost.

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The benefit for the government and SOEs is that more money will be available for investment and, as a result, the interest rate they will have to pay will be lower. This frees up funds for other projects that could increase the profitability of the SOE and, in the case of the state, decreases the need to increase tax rates.

And since prescribed assets are still earning a return, they will be much less detrimental than increases in tax rates at this stage. Any increase in tax rates will result in less employment and economic development, which in turn will decrease future tax collection.

The risks associated with prescribed assets, however, outweigh their benefit. If the government and SOEs know there is a guaranteed source of funding, there is little incentive to improve their operations and the risk of maladministration continues. The main concern, however, is that available funds are not unlimited. If specific investments are prescribed, funds will have to be withdrawn from other investments that could have provided a better future for South Africa. It therefore prevents the optimal allocation of funds and reduces the potential economic growth the country can achieve.

What is government and the ruling party's stance?

Currently, there is no project on the go from either government or the ANC to force prescribed assets. While many statements have been made by members of the tri-partite alliance, the government itself has not provided a clear policy stance on the matter to date. On 17 August 2020, Enoch Godongwana, chairperson of the ANC's subcommittee on economic transformation, stated that the ANC is not proposing that pension funds be used to bail out state-owned enterprises or to create a state-owned bank, but it wants pension funds to be used to fund profitable infrastructure projects.

Over the past few months, the ANC and National Treasury have been in discussion with the private pensions industry on the best way forward to allow pension funds to invest directly in infrastructure projects. Due to the size, liquidity and long-term nature of infrastructure projects, it is currently impossible for pension funds to invest in such projects.

The current discussion is therefore focused on how to change Regulation 28 under the Pension Funds Act and how best to structure the projects to access the funding available in pension fund schemes for these projects. If this can be achieved and profitable infrastructure projects are identified, this could provide pension funds with a great growth opportunity and increase the future GDP of the country. This process is nearing finality as announced during the Medium Term Budget Policy Statement, and we will only be in a position to analyse the proposed changes in more detail once published.

It is, however, also very clear that the total funds required by infrastructure projects are significantly higher than the funds available within South African pension funds. Regulation 28 will therefore not be a silver bullet for our economy. A strong focus on persuading offshore investors to provide fixed investments to South Africa will be needed.

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