By Ngoku-Sakhile Mazwi

INFRASTRUCTURE

Why pension funds should support GDP

Pension funds could support the knock-on effects of more money flowing into infrastructure projects to assist in South Africa's economic recovery.

The correlation between investment in capital infrastructure and GDP has been shown by IMF and World Bank data collected between 1960 and 2019. These studies demonstrate that 54% of all GDP performance can be explained by a country's investment levels. At this juncture in South Africa's economic history, given the contraction of the economy and the added impact of Covid-19, it is increasingly important to prioritise investment as a stimulant for GDP growth and economic development.

Specifically, infrastructure investments have been empirically proven to have a significant impact on economic growth and to also reduce inequality, according to the *International Journal of Critical Infrastructure Protection.* Aschauer's seminal paper, published in 1989 in *Industry Week,* triggered a voluminous amount of research into the sector by noting strong links between infrastructure investment and economic growth. Belloumi and Achour later proved a causal relationship between transport infrastructure, energy consumption and GDP. In sum, what these studies demonstrate is that a 1% increase in a country's infrastructure stock is directly correlated to a 1% increase in GDP. It is therefore the impact of infrastructure that makes its investment case compelling.

The recently held Sustainable Infrastructure Development Symposium (SIDS) and attendant sustainable infrastructure development methodology are thus a recognition, on the part of government, of the benefits of an infrastructure-led growth plan. What SIDS asserts is that SA needs an investment target of at least 30% (from our current 16% to 18%) to transform into an investment-led economy. Stimulating private sector infrastructure investment, then, forms part of this strategy.

But what is infrastructure?

There is no dominant, singular understanding of what infrastructure is. Most definitions share an overlapping view of infrastructure as a reference to: power plants, power distribution networks, oil and gas pipelines, roads, bridges, railways, harbours, airports, water purification and treatment plants, water pipelines, potable water supply, dams, telecommunications and communication networks, sewage facilities, housing services and human settlement, urban services, and irrigation networks.

The Organisation for Economic Cooperation and Development (OECD) defines infrastructure simply as "the system of public works in a country, state or region, including roads, utility lines and public buildings".

In the investment industry, we typically group and differentiate between economic infrastructure and social infrastructure assets. Economic infrastructure is a reference to power, transport, water and information and communications technology (ICT) assets; and social infrastructure refers to student housing, schools, human settlements, clinics, hospitals and wellbeing.

Furthermore, investors identify quality infrastructure assets based on their economic and financial investment characteristics, which include high barriers to entry, economies of scale, inelastic demand, lower volatility or correlation to economic swings and listed markets, predictable cash-flow yields based on long-term agreements, as well as public-goods attributes linked to a tendency towards monopoly, according to a paper by Inderst.

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of GDP.

It is because of these public-goods attributes that government regulation is required to ensure that infrastructure is appropriately priced. However, infrastructure assets do not all behave the same. ICT, as an example, has sufficient attributes to incentivise competitive private participation and therefore does not require too much government involvement.

Nevertheless, infrastructure projects typically have network-effects benefits and address spatial inclusion. Thus, the net public benefit or economic gross value-add from infrastructure investments exceeds their private sector return. For this same reason, some infrastructure sub-sectors, such as social housing, get underprovided for by the private sector and need blended finance solutions to attract the private sector.

SA has historically underinvested in infrastructure, achieving infrastructure investment levels of only 4.7% of GDP, according to the McKinsey Global Institute. In comparison, India and China, SA's bigger BRICs associates, have been investing between 8% and 13% of GDP in infrastructure consistently since the 1990s, according to the Reserve Bank of Australia.

As a way forward, then, there is a requirement to amend policy to enable more private investment in infrastructure. Regulation 28 (the regulation governing pension fund asset allocation) has the potential to unlock an estimated R120bn for direct investment in infrastructure, according to estimates by the Association for Savings and Investment SA (Asisa) and National Treasury. The impetus to amend regulation 28 comes from the requirement to use the regulatory framework to provide clearer guidance to the pension fund market on its role in the nation's infrastructure-led growth strategy and, more generally, the National Development Plan.

As demonstrated, infrastructure investment is a proven path to economic recovery, but perhaps more importantly, it concurrently delivers much-needed socio-economic value by enhancing the lives of the excluded and underprivileged. ■

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