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Socially-targeted investment:

Strategy Paper

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While all NALEDI publications adopt a pro-labour perspective, their conclusions do not represent the policies of COSATU

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1. INTRODUCTION

South Africa urgently needs investment that can boost development and address poverty. This paper focuses on socially-targeted investment, which has been the subject of ongoing negotiations particularly at the Growth and Development Summit in 2003. The goal of the paper is to propose an investment framework that promotes the creation of meaningful economic opportunities for working people and the poor in South Africa.

In June 2003, stakeholders from government, business, labour, and community participated in a Growth and Development Summit (GDS) hosted by the National Economic Development and Labour Council (NEDLAC). One outcome of the GDS was an agreement to increase investment - to encourage growth and development. Section 3.1.4 of the GDS Agreement reads:

> *The constituencies agree to encourage investors, including businesses (local, foreign, public and private), retirement funds, the life assurance industry, government, labour, and community organisations to work towards investing 5% of their investible income in appropriate financial instruments.* [1]

In his State of the Nation Address in May 2004, President Thabo Mbeki reaffirmed that "we will engage our social partners to implement the decision taken at the Growth and Development Summit that 5% of the funds held by the institutional investors will be invested in the real economy."[2] The details of the GDS agreement are still being negotiated, including: (1) Who is responsible for contributing? (2) What is "investible income" (5% of what)? (3) What investments will best expand economic opportunity for poor people? (4) How should the process be administered and monitored?

As can be expected, consensus on the "who is to invest?" is relatively easier to reach than on "what is to be invested?" and "how to implement the investment?" Regarding the "who", representatives of business and labour both suggest that investors responsible for contributing to the 5% are in the financial sector, primarily pension funds and life assurers. [3] The question of "what" is somewhat more complicated since business predictably seeks to limit the scope of the agreement. The term "investible income" has been a contested phrase, often interpreted as after-tax profits by business and rejected by labour and government as too small of an amount to make much difference. Many in the NEDLAC process answer the "what" question by asserting that the amount should be 5% of the total assets of non-discretionary savings (i.e., long-term and short-term assurers and government, private and self-administered pension and provident funds). In 2003, these assets totalled about R2 trillion, with 5% being about R100 billion. In any case, the Department of Finance is encouraging NEDLAC members to come up with a quantifiable variable.[4]

The purpose of this paper is to gather input from all stakeholders on the second two questions, specifically "what investments will best expand economic opportunity for poor people?" and "how should the process be administered and monitored?" The following section of the paper, Section 2, provides background on South Africa's historic lack of socially-targeted investment

[1] National Economic Development and Labour Council (NEDLAC), *Growth and Development Summit Agreement*, Section 3: "Addressing the Investment Challenge," June 2003.
[2] President Thabo Mbeki, "State of the Nation Address," 21 May 2004.
[3] Neva Makgetla, COSATU, interview with author, 15 July 2004; Dennis Dykes, NEDCOR, interview with author, 4 August 2004. Cas Coovadia of the Banking Council suggests that banks might also be included, and that eventually the grouping should be expanded to include other sectors of the economy. If this occurs, he suggests that the 5% amount should be determined on a sector-by-sector basis. Cas Coovadia, Banking Council, interview with author, 5 August 2004.
[4] Elias Masilela, interview with author, 3 August 2004.

and the structural poverty crisis that may be alleviated by such investment. Section 3 presents several types of infrastructure and productive investments and evaluates them according to social impact, financial return, and implementation issues. Section 4 describes three possible methods of administering the investment initiative and compares them based on criteria including transparency and accountability, local/community participation, and implementation feasibility. The fifth and final section offers recommendations and conclusions.

2. CYCLE OF LOW INVESTMENT, LOW GROWTH, AND POVERTY

2.1 Lack of Socially-Targeted Investment in South Africa

South Africa currently has insufficient investment targeted toward development needs. Evaluating South African Reserve Bank data, economist Simon Roberts notes that "at 14,7% of GDP in 2001, the country's ratio of gross fixed capital formation to gross domestic product [i.e. rate of investment] was at its lowest level for more than twenty years."[5] Related to this, South Africa's GDP grew by only 1.9% between 1990 and 1999, compared to an average of 3.5% for other middle-income countries. [6]

South Africa's investment problem is partially due to the Apartheid system, which deliberately underinvested in the social and economic needs of the majority of the population. However, the last ten years have not seen an adequate increase in socially-targeted investment. In the mid- to late-1990s, the South African government assumed that macroeconomic stabilisation would by itself encourage investment. The tight monetary policy practised under the Growth, Employment, and Redistribution (GEAR) programme did stabilise some aspects of the economy, primarily the budget deficit and inflation. However, it also raised interest rates, which increased the cost of borrowing, and subsequently reduced investment. The exchange rate also fluctuated considerably, creating high levels of uncertainty. A problematic cycle was created, in which low investment reinforced low growth levels, and low growth in turn discouraged investors.[7]

Socially-targeted investment has been hit especially hard. Despite claiming some success in connecting people with water, electricity and other basic services, the government admits to a large infrastructure investment backlog. [8] Moreover, the private sector has been dominated by a short-term focus on investments that deliver a quick profit.

Investors have historically not developed systems to evaluate the probability of repayment from smaller businesses, underdeveloped sectors, and other projects that might create jobs or other positive social impacts over time. With less information about whether such a project will default, financial returns on these projects are far more uncertain, and investors have been unwilling to take the risk of investing in these areas. [9] Thus the socially responsible investment (SRI) firm Futuregrowth Asset Management reports that in South Africa, socially-targeted investment comprises about 1% of the entire investment industry, far behind countries like the United States, in which SRI funds make up 12% of the investment industry. [10]

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[5] Roberts, pages 2-3. By contrast, 40% of China's GDP is fixed investments, says Duma Gqubule of the Black Economic Empowerment Commission. Duma Gqubule, phone interview with author, 16 July 2004.
[6] Simon Roberts, "Analysis of Investment Needs for Development: Investment and the Financial System," March 2003, page 3.
[7] Black Economic Empowerment Commission*, BEE Com Report,* 2001, page 10.
[8] Elias Masilela, Department of Finance, interview with author, 3 August 2004.
[9] Roberts, pages 5-6.
[10] Lisa Christodoulou, Futuregrowth Asset Management, interview with author, 2 August 2004. Futuregrowth notes that in South Africa SRI consists of two categories: (1) ethical investment, which

Although South Africa's private pension and insurance sectors are estimated to be the largest in the world relative to gross national product,[11] these sectors have also eschewed long-term investment, perceiving it as too risky, even though recently these investors have also been generating poor financial returns on their short term investments.

2.2 Poverty and Inequality

One of the disturbing results of this "short-termism" is continuing poverty, inequality and unemployment. The government has made strides in extending the "social wage" – free or subsidised basic services and housing – to thousands of people. However, almost half of South Africa's population (about 22 million people) remains impoverished.[12]

Short-sighted investment has also failed to correct the huge economic disparities created by colonialism and Apartheid. In 2001 South Africa was among the 50 wealthiest countries, with a per capita annual income of $11,240 corrected for purchasing power parity. However, in the same year, South Africa was ranked 111th out of 175 nations on the Human Development Index (HDI), which is a composite of life expectancy, education, and standard of living. [13]

Certain groups suffer disproportionately from poverty. In 1995, 65% of individuals lived below the poverty line in rural areas, compared to 22% of urban dwellers.[14] Women and female-headed households also face higher poverty rates, due to factors including lower wages and job discrimination, minimal access to assets, and responsibility for reproductive labour, such as childcare and household work.[15]

2.3 Unemployment

Lack of long-term and productive investment has also exacerbated a structural unemployment problem.[16] The colonial and Apartheid regimes contributed to the unemployment crisis by promoting capital-intensive production processes and the underdevelopment of skills of the vast majority of the population. Since the fall of Apartheid, tight monetary policy and rapid trade liberalisation have contributed to job losses and a shift toward worse-paying and informal sector employment.

South Africa's official and expanded unemployment rates are 28,2% and 41,8% respectively. [17] Among the unemployed in September 2003, almost 60% have never been employed. A

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includes environmental, religiously screened, and corporate governance; and (2) development investment, which includes Black economic empowerment, private-public partnerships, and infrastructure.

[11] Taylor Committee, Department of Social Development, "Transforming the Present - Protecting the Future. *Draft Consolidated Report*. Report of the Committee of Inquiry into a Comprehensive System of Social Security for South Africa," 2002, page 93.

[12] Charles Meth and Rosa Dias, "Increases in Poverty in South Africa, 1999-2002" in *Development Southern Africa Volume 21, Number 1, March 2004*, especially pages 70 and 83.

[13] UNDP 2002; Leibbrandt, Woolard, and Bhorat found that just 6% of the nation's population acquires over 40% of the income. M. Leibbrandt, H. Bhorat, and I. Woolard, "Household Inequality and the Labor Market in South Africa," in *Contemporary Economic Policy*, 2001, Volume19, pages 73-86.

[14] Leibbrandt, Woolard, and Bhorat, 2001; 1995 Income and Expenditure Survey.

[15] James Heinz, "Poverty and Economics in South Africa," NALEDI, 1995, pages 2 and 24-25; Dorrit R. Posel, "Who Are the Heads of Household, What Do They Do, and Is the Concept of Headship Useful? An Analysis of Headship in South Africa," *Development Southern Africa* Vol. 18, No. 5, Dec 2001, page 669.

[16] In his paper, "Poverty and Economics in South Africa," James Heinz defines structural unemployment as "unemployment which cannot be explained by the periodic growth and contraction of an economy." James Heinz, page 22.

[17] Statistics South Africa, Labor Force Survey – September 2003. March 2004

comparison to other middle income countries, which have an average jobless rate of under 10%, confirms the structural nature of South Africa's unemployment problem. [18]

2.4 Coping Strategies

With the assistance of family, community, and government, people have developed a number of strategies to cope with extreme poverty. These coping mechanisms include:

- Private transfers, also known as remittances, through which poor people provide financial assistance to each other.
- Public transfers, i.e., measures taken by the government to alleviate poverty, such as old age pensions, disability grants, and child support grants. [19]
- Employment in the informal economy and through casual work. Development economists emphasise the limits of the informal sector, including low incomes, poor working conditions, and lack of government regulation. [20]
- Migration to other geographic areas, including cities. [21]

These coping mechanisms do not offer people sufficient assets and stability to take risks such as starting small businesses or other economic activities. In short, these strategies alone will not address poverty and structural unemployment for the long term.

2.5 A Different Way – Shifting the Focus toward the Long-Term

Through the GDS Agreement on investment ("The 5% Initiative"), the parties have acknowledged that growth and development requires increased access to financial and economic resources for the majority. Correspondingly, enhanced majority access requires a shift away from a short-term investment focus. This shift need not compromise private sector interests or the interests of workers whose retirement capital is tied up in these funds. Investment managers and others emphasise that well-managed and diverse portfolios of socially responsible investments (SRI) can deliver above-average financial returns.[22]

Moreover, members of the private sector recognize that if they do not invest in long-term infrastructure and other needs now, they may not have a well-functioning economy in several years time. Cas Coovadia of the Banking Council stresses that investing for the long-term should be promoted as a major opportunity for the business sector. Investing in what he calls "transformational infrastructure" is shifting from "business as usual" to "doing business in a different way," by investing in long-term profitability. [23]

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[18] World Bank 2003, cited in People's Budget Campaign, page 4.

[19] In their paper, "Trends in Living Conditions and Satisfaction Among Poorer Older South Africans," Valerie Møller and Richard Devey note that the 1998 October Household Survey reveals that three-quarters of older black households reported receiving income from a state old-age pension. Valerie Møller and Richard Devey, "Trends in Living Conditions and Satisfaction Among Poorer Older South Africans: Objective and Subjective Indicators of Quality of Life in the October Household Survey," in *Development Southern Africa*, Vol. 20 No. 4, Oct 2003, page 469.

[20] Richard Haines and Geoffrey Wood, "Unemployment, Marginalisation and Survival in Greater East London," in *Development Southern Africa*, Vol. 19, No. 4, Oct 2002, pages 577-579; Heinz, page 27.

[21] Haines and Wood, page 578. Haines and Wood stress that the structurally unemployed are often reluctant to migrate in search of work, because of their need to stay close to social support networks.

[22] Andrew Canter, Futuregrowth, interview with author, 2 August 2004; Karl Gostner, "Socially Responsible Investment in South Africa," March 2004, page 11.

[23] Cas Coovadia, interview with author, 5 August 2004. Dennis Dykes agrees that a large benefit of the 5% Initiative is that it will help investors to look with new eyes at socially-targeted investment, and see that it can have both financial and social returns. Dennis Dykes, interview with author, 4 August 2004.

In addition to doing business in a new way, long-term, socially-targeted investment can help South Africa escape from its present cycle of poverty, unemployment, and stunted growth. According to World Bank economist Dominique Van de Walle, "the more poor (and hence credit constrained) people there are, the lower the rate of growth, and the more likely poverty will persist." [24] Several studies of growth in various countries support the assertion that investment is a key step toward enhanced growth. [25] Socially-targeted investment in particular moves assets from richer parts of the economy to poorer. Once poor people access such assets, they are better placed to finance education, new small businesses, and engage in other economic activities.

3. ANALYSIS OF INFRASTRUCTURE & PRODUCTIVE INVESTMENTS

For the purposes of the 5% initiative, there are two major types of socially-targeted investment: infrastructure investment and productive investment. Infrastructure investment boosts the physical capital, services, and human capacity that support the economy. Infrastructure includes housing, utilities, roads, transport, health clinics, and school buildings. Productive investment entails funding processes that make the economy more productive, such as labour-intensive sectors; small, medium and micro-enterprises (SMMEs); and education and skills training.

This section of the paper evaluates several types of infrastructure and productive investments in terms of social impact, financial risk and return, and implementation issues. Before beginning the evaluation, a brief definition of the terms of analysis follows.

In their 2003 paper Social Return on Investment: Standard Guidelines,[26] Sara Olsen and Alison Lingane define social return on investment as a measure which "describes the social impact of a business or non-profit's operations in dollar terms, relative to the investment required to create that impact and exclusive of its financial return to investors." Further, social return on investment (SROI) is a benchmark that has meaning only in context. Therefore SROI of an investment must be evaluated in comparison to the SROI of other investment projects, or to the SROI of the same project over time.

Several business and government stakeholders commented on the difficulty of measuring social impact, especially because some positive results may take several years to appear. They recommended economic methods including general equilibrium models, cost-benefit analyses, and input-output frameworks. Parties also noted that different types of investment would need to be measured in different ways, so that evaluation might need to be on a project-by-project basis.[27] In any case, stakeholders in government, labour, and business generally agree that SROI should not be used as the primary indicator of social impact. First, policymakers may have goals that are not addressed by the SROI model, such as redistribution of assets or targeting to the poorest and most marginalised groups. Second, SROI may be too time-consuming or expensive to be used across the board. Cas Coovadia suggests starting with a limited geographical intervention,

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[24] Dominique Van de Walle, "Are Returns to Investment Lower for the Poor?" page 2.

[25] Easterly and Rebelo, 1993; De Long and Summers, 1993; Temple 1998, cited in Roberts, page 1.

[26] Sara Olsen and Alison Lingane, *Social Return on Investment: Standard Guidelines*, 2003, page 4, www.haas.berkeley.edu/responsiblebusiness/docs. Olsen and Lingane refer to a SROI framework that is used by the Global Social Venture Competition at Haas School of Business, University of California, Berkeley. This model uses five steps to calculate the SROI: (1) quantify non-financial impact of operations per unit, (2) translate into monetary terms per unit to achieve "social cash flows," (3) sum all social cash flows for the time horizon in question, (4) discount social cash flows to present value, (5) divide total discounted social cash flows by investment to date to arrive at the SROI.

[27] William Frater, Frater Assets, interview with author, 2 August 2004; Elias Masilela, interview with author, 3 August 2004; Dennis Dykes, interview with author, 4 August 2004.

measuring that, and then expanding investment and evaluation. COSATU's Neva Makgetla suggests evaluating the number of jobs created, and measuring jobs created by sector instead of by each individual project.[28] Representatives from the three constituencies suggested the following quantitative indicators of social impact:

- Job-creation
  - Number of full-time equivalent jobs
  - Number of above minimum wage jobs &/or living wage jobs
  - Number of people who are newly employed
  - Job duration (i.e., sustainability of jobs)
  - Number of jobs created per R1 million
- Housing – number of people in formal housing
- Basic Services – number of homes with access to water, electricity, sanitation, telephone
- Enhanced Economic Opportunity – number of other economic activities created by investment

Parties also noted that the 5% Initiative might borrow from the Financial Sector Charter, which will put in place mechanisms to track progress in housing, infrastructure, and other investments.[29] In addition, qualitative data and narrative descriptions are vital sources of information that can evaluate a project's ability to improve people's lives. Vusi Gumede from the Office of the President suggests that the targeted beneficiaries should also evaluate an investment's efficacy. [30] Therefore to supplement any output measures, surveys could be designed through which people could self-report on improvement or decline in health, access to services, economic opportunities and other areas of life.

Qualitative data would help determine not only the number of jobs created by an investment, but also the longer-term impact of those jobs, such as enhanced family income, health, and education. For finance to SMMEs, data collection and evaluation could make use of case studies and survey methods. To measure the growth of certain sectors or labour-intensive activities, one could utilise descriptive analyses of trends since the inception of the investment project. [31]
Data collection is a key preliminary step that facilitates measures of social impact. In some cases, labour, community, and business organisations will be able to assist government in providing this data. In addition, all parties pointed to the need for an independent assessment of projects' social impact.

Financial Risk and Return

In the mainstream investment arena, the primary purpose is profit-making, or gaining a satisfactory return on investment (ROI). However, some stress the social aspect of socially-targeted investments, and question whether it is critical to achieve a market-average financial return, especially given the social investments will be only 5% of the total. [32]
Other stakeholders who are these, business? insist that these social investments must be commercially viable and deliver a decent financial return. They emphasise that any investment cannot be considered charity and that the private sector does not wish to take on government's responsibility, but instead support viable projects that had previously been overlooked.

[28] Cas Coovadia, interview with author, 5 August 2004; Neva Makgetla, interview with author, 15 July 2004.
[29] Cas Coovadia, interview with author, 5 August 2004. The Financial Sector Charter is a parallel process to the 5% Initiative, in which the financial sector is setting targets for investment in development.
[30] Vusi Gumede, Office of the President, interview with author, 27 July 2004.
[31] Vusi Gumede, interview with author, 27 July 2004.
[32] Elias Masilela, interview with author, 3 August 2004.

Nonetheless, all stakeholders reiterated that investing 5% in socially-targeted projects must not jeopardise people's pensions. Thus an investment strategy must find a balance between achieving social goals while guaranteeing an appropriate return to fund members. In fact, given the negative trend that many people have seen their funds return in recent years, the promise of a guaranteed return in exchange for social-targeting may be welcomed by many pension fund members and trustees.

Therefore, while socially-targeted investment emphasises social impact, including financial risk and return analysis can increase the buy-in of investors. This is crucial to successful implementation of the GDS investment agreement.

Implementation Issues

In addition to financial return and social impact, it is important to consider the ability to implement different investments. Specific concerns include practical feasibility, political feasibility, and measurable outcomes. For example, investment in low-income housing may be more practically feasible than other investment projects because government has been investing in housing and has set up mechanisms for procurement and other processes. Investment in economic infrastructure like roads might be more politically feasible than investment in health or skills training programmes because business stakeholders might believe that health and education should be the responsibility of government. In an effort to monitor how well investment is alleviating poverty, parties will also want to choose investment projects that can demonstrate progress through measurable outcomes such as the number of jobs created.

3.1. Infrastructure Investment

a. Economic and Social Infrastructure

Social Impact

Infrastructure is often divided into two categories: economic infrastructure and social infrastructure. Economic infrastructure includes projects such as roads, bridges, dams, electricity and water supply. It is worth noting that investments in economic infrastructure tend to have a better record of employment creation. [33]

Social infrastructure includes resources such as school buildings, hospitals, and administrative services. Research has also shown that improved access to water, sanitation, electricity, and health services improves health, in ways such as decreasing child mortality rates. Moreover, these infrastructure services decrease women's reproductive labour and enable them to participate more in the economy. Increasing unemployed people's access to affordable transportation enables them to increase their job searches. [34]

All constituencies emphasised the need to invest strategically. Vusi Gumede (government) stresses that we should not finance investments that are not well-planned, but instead support projects that build on existing infrastructure, such as a road that enables rural populations to reach a health clinic. [35] Old Mutual's Derrick Msibi (business) emphasises that infrastructure projects should be located in rural areas or other communities where poverty and unemployment are most in need of alleviation. That way the investment effort can "create a node [of economic

[33] Willem Kemp and Robert Macdonald, "Infrastructure Investment: an Overview," NALEDI Pension Fund Unit Research Paper Series, March 2004, page 22.
[34] Elias Masilela, interview with author, 3 August 2004.
[35] Vusi Gumede, interview with author, 27 July 2004.

development] around the project." [36] Jan Mahlangu (labour) agrees that investment projects must be linked with local communities and municipalities to have the largest impact. [37]

Financial Risk and Return

Economic and social infrastructure projects (such as utilities and transport) have long investment lives, from 20 to 100 years or longer. In the experience of Australia, both equity-based and debt-based infrastructure investment instruments have a low financial risk and medium financial return. For example, unlisted infrastructure in Australia has a risk level between bonds and property, and returns that are higher than bonds and property. Listed infrastructure equity (listed on the Australian stock exchange) has a higher return than unlisted infrastructure, but also carries a higher risk profile. [38]

Derrick Msibi reports that in their infrastructure investments, Old Mutual aims for a financial return of 7% above inflation, and achieves that return in the vast majority of cases. [39] Another illustration of infrastructure investments' successful financial return is provided by two infrastructure funds at Futuregrowth. Since its inception, Futuregrowth's Infrastructure Bond Fund performed at a 19,4% against an 18,5% All Bond Index benchmark. Futuregrowth's Community Property Fund achieved a return of 13% since inception against a 10,6% benchmark consisting of inflation plus 4%. [40]

Implementation Issues

Clearly, while investment in social infrastructure is necessary, this may be less appropriate for socially-targeted investment since issues such as health care and education are seen as the responsibility of government and civil society, not private investors. On the other hand, investment in economic infrastructure, particularly linked to local economic development, seems to be an area of consensus emerging from the Growth and Development Summit (GDS) Agreement. [41]

Government could play a role as coordinator, linking a comprehensive urban and rural development strategy to increased public and private investment in infrastructure. Cas Coovadia suggests that the "deal flow" will often need to start from government because it can most easily identify infrastructure needs. [42] The government could identify and weight the priorities for investment in infrastructure (e.g. 30% in roads and transport, 15% in energy, etc.), and share them with all parties to best direct infrastructure investment.

Measurable outcomes could include all of those listed under *Definition of Terms* (jobs, housing, basic services, and economic opportunities). However, because socially-targeted investment (particularly in infrastructure investment) is fairly new in South Africa, targeted research and skilled personnel are necessary to further facilitate practical implementation and measurable outcomes.

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[36] Derrick Msibi, Old Mutual Asset Management, interview with author, 20 July 2004.
[37] Jan Mahlangu, COSATU, interview with author, 5 July 2004.
[38] Willem Kemp & Robert Macdonald, pages 5, 8-9.
[39] Derrick Msibi, interview with author, 20 July 2004.
[40] Andrew Canter, interview with author, 2 August 2004; Willem Kemp & Robert Macdonald, page 15.
[41] Vusi Gumede, interview with author, 27 July 2004; Elias Masilela, interview with author, 3 August 2004.
[42] Cas Coovadia, interview with author, 5 August 2004.

b. Housing Construction

Social Impact

Formal housing can have long-term affects such as residents being less exposed to the elements, having improved health, and as a result, being more productive in the economy. [43] At the same time, investment in low-income housing construction can have the double positive outcome of redistributing assets and generating employment for poor people. However, residents of subsidised housing currently do not have full access to the asset. They are not allowed to sell the dwelling for a period of eight years after occupying it. In addition, many housing construction jobs are temporary and migratory and build limited skills.

Financial Risk and Return

Elias Masilela identifies low-income housing as an investment that can benefit all parties, by generating the positive social returns mentioned above while at the same time creating decent financial return. Cas Coovadia suggests that housing has potential for good financial return, because he identifies housing as a priority area for the banking sector in the next five years. [44]
Black Economic Empowerment Commission researcher Duma Gqubule notes that investment in lower-middle income housing could also offer a decent return. He estimates that there are two million lower-middle income people – nurses, teachers and the like – who earn about R5 000 a month but cannot buy homes where they would like to live. They are above the low-income housing subsidy line but cannot afford housing prices outside of townships. If lower-interest loans were available and/ or government provided guarantees, these 2 million individuals could purchase homes for R100 000 per house, creating a R200 billion market. [45]

Implementation Issues

Investing in housing construction should be practically feasible because it adds to the government's low-income housing efforts. In terms of political feasibility, constituencies agreed at the GDS that local economic development, including housing, is an important way to combat poverty and promote growth. Low-income housing was mentioned by all constituencies as an important area for investment. [46]
Measurable outcomes would include number of people in formal housing as a result of an investment project.

3.2. Productive Investment

a. Labour-intensive activities

Social Impact

Investment in labour-intensive sectors can result in creation of a high number of sustainable jobs. Sectors such as agriculture, construction, light industry and services can offer jobs to particularly vulnerable groups such as African women and rural communities. One success story is a socially-targeted investment by a pension fund in a furniture factory in Atlantis, Western Cape.

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[43] Elias Masilela, interview with author, 3 August 2004.
[44] Elias Masilela, interview with author, 3 August 2004; Andrew Canter, interview with author, 2 August 2004; Cas Coovadia, interview with author, 5 August 2004. Cas also stressed that social infrastructure is also necessary in marginalised geographic areas to support housing finance.
[45] Duma Gqubule, phone interview with author, 16 July 2004.
[46] Elias Masilela, interview with author, 3 August 2004; Cas Coovadia, interview with author, 6 August 2004; Lisa Christodoulou, interview with author, 2 August 2004; Neva Makgetla, interview with author, 15 July 2004.

After many residents of Atlantis had been retrenched from Saldhana Steel, the jobs at the furniture factory helped alleviate chronic unemployment and deep poverty.[47]

Government, labour, and business again stressed the need for strategic thinking. Jan Mahlangu (labour) proposes investing in labour-intensive parastatals, to prevent retrenchments. Vusi Gumede (government) suggests investing in sectors with potential to grow the economy such as transport and sustainable forms of energy. Derek Msibi (business) emphasises that buying shares in listed investments is not sufficient to address unemployment. He argues that job creation will come from projects that increase the stock of capital, such as Greenfield investments (new endeavours). Further, he insists that the 5% set aside for socially-targeted investment should not be funnelled to major industrial companies because they already have the financing to create jobs, and should be doing so anyway. Nonetheless this can be expected to remain a sticking point, as many in business would want to channel this money to equity rather than job creating-greenfield investments.

Financial Risk and Return
Greenfield ventures may generally perform less well than equity investments, but stakeholders suggested that once there is a menu of such labour-intensive investments to choose from, the market will gravitate toward those Greenfield investments with the highest financial return. [48]

Implementation Issues
Business delegation representatives are obviously uncomfortable suggesting that 'particular sectors should be targeted or excluded. They also argue that it would be economically unsustainable to support only a few industries. Instead, criteria such as capital-output ratios might be used to identify labour-intensive activities.[49] However, through the Financial Sector Charter, business, labour, and government seem to have agreed upon the importance of investing in at least one labour intensive area – black-owned agriculture. [50] Therefore the principle of targeting specific sectors is agreed and must be pursued vigorously.

Measurable outcomes in these sectors, as in the Financial Sector Charter, would focus on number, duration, and type of jobs created.

b. Small, medium and micro-enterprises (SMMEs) & Cooperatives

Social Impact
SMMEs and cooperatives have often emerged in poor communities as a way to expand employment and income opportunities. Cooperatives build on local support networks, offering workers autonomy and a democratic structure. As about 70% of the informally self-employed are women, support for SMMEs and co-ops would be a good way to reach this vulnerable group. In addition, subsidised finance of SMMEs would help assets to flow from wealthier to poorer parts of society. However, the investment strategy would also need to address the very real limits of informal activity – including low incomes, poor working conditions, episodic employment, and lack of government protection.

Financial Risk and Return
Futuregrowth does not invest in SMMEs or skills development because it considers these activities too small, hands-on, and risky to generate reliable financial returns. Instead this fund

[47] Rustum Omar, Fifth Quadrant, phone interview with author 19 July 2004.
[48] Dennis Dykes, interview with author, 4 August 2004.
[49] Dennis Dykes, interview with author, 4 August 2004.
[50] Neva Makgetla, interview with author, 15 July 2004.

management company suggests that government and non-governmental organisations (NGOs) should provide direct support to SMMEs. [51]

On the other hand, Frater Assets' William Frater points out that although infrastructure investments such as new shopping centres may be more viable financially, small business may create a more sustainable local economy, employing residents and reinvesting profits in the community. This could result in a larger financial return for the local community. [52]

Implementation Issues

Support for SMMEs and co-ops should not encounter political or practical feasibility barriers, as microcredit initiatives are currently popular and models for their implementation widespread. However, members of the private sector suggest that the 5% should support SMMEs only indirectly, for example by investing in an accredited microlender.

In addition, trade union representatives emphasise that (1) co-ops need far better access to credit, and (2) access to capital is not enough by itself. Members of SMMEs and co-ops also need skills training and education to make the best use of credit and other opportunities. [53] Co-ops in particular need support in producing adequate business plans and strategies to handle efficiency challenges. [54]

Measurable outcomes for SMMEs and co-ops could include jobs created and other economic opportunities generated.

c. Skills Training and Education

Social Impact

Much research has shown that investments in education increase returns to simultaneous investments in credit and infrastructure. In addition, creating a larger pool of workers trained in skills relevant to expanding sectors can attract further private sector investment and subsequent job-growth in a given locality. [55]

Financial Risk and Return

Obtaining a financial return from education and skills training projects would require certain types of investment. Two possible return-generating investments are (1) private universities and (2) student loan programmes such as those offered by the Department of Education.

Implementation Issues

Political challenges may arise from stakeholders who are reluctant to invest in skills training and private education because they view these areas as the responsibility of government. They may point to the existence of Department of Labour programmes, the implementation of the Skills Development and Levy Acts, and the Sector Education and Training Authorities (SETAs) as evidence that education and training needs are being addressed. In fact, of the infrastructure and productive investments listed in this paper, skills training and education is the one general category not proposed by business for inclusion in the Financial Sector Charter. [56]

In education, measurable outcomes could include numbers of matriculants in high-demand skill areas, and numbers of matriculants placed on jobs.

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[51] Andrew Canter, interview with author, 2 August 2004.
[52] William Frater, interview with author, 2 August 2004.
[53] Jan Mahlangu, interview with author, 5 July 2004.
[54] Devan Pillay, NALEDI, interview with author, 16 July 2004.
[55] Haines & Wood, pp 579-80.
[56] Neva Makgetla, interview with author, 15 July 2004. Organised business has proposed the following investment areas for the Financial Sector Charter: black agriculture, SMMEs, low-income housing, and infrastructure.

Box: Grace Bible Church – A Social Investment Success Story

Through its Infrastructure Bond Fund, Futuregrowth helped Soweto's Grace Bible Church build its own building. Grace Bible Church was started in 1983 by 20 people meeting at Mavis Hall in White City, Jabavu. In 2001 Futuregrowth structured a mortgage loan made possible by the church's savings record, management skills, and cash flows. The church was able to build a multipurpose centre which is one of the largest private community centres in Soweto. The new building accommodates 5 000 people, and is used for church services as well as courses in adult basic education, computer skills, and HIV/AIDS awareness. [57]

4. ANALYSIS OF POTENTIAL INVESTMENT ADMINISTRATION METHODS

In addition to determining what types of economic activities to invest in, the parties must decide how to administer the 5% Initiative. This section of the paper examines three possible administration methods: voluntary investment, a social investment fund, and prescribed investment through a defined "investment universe". The methods are evaluated based on the following criteria: transparency and accountability, local and community participation, and implementation issues.

4.1 Voluntary Investment, Administered by Private Sector

Description

A voluntary socially-targeted investment model would be a self-imposed code, similar to the Financial Sector Charter and most similar to the status quo. Institutional investors would increase their socially-targeted investments until they reach 5% of total assets.
Investment methods would include existing vehicles, such as:

- national and local government bonds
- parastatal and quasi-government companies (e.g., Eskom, Telkom, Transnet)
- private-sector listings, listed on the Johannesburg Stock Exchange
- private equity funds that are unlisted
- special open funds and units trusts (e.g. such as currently operated by African Harvest, Futuregrowth, Old Mutual Asset Management)

New vehicles could include a national infrastructure bond, bonds in small municipalities, and additional listed and unlisted equity options. [58]

Supporters of this method argue that government and NEDLAC processes do not have the capacity to administer the 5% effort. They suggest that instead it should be farmed out to private investment management companies that have a track record in SRI and an interest in the process because of the opportunity to profit. [59]

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[57] Andrew Canter, interview with author, 2 August 2004; Futuregrowth brochure, "Targeted Investments: Sound Economic Returns and Social Impact," page 4.
[58] Dennis Dykes, interview with author, 4 August 2004.
[59] Cas Coovadia, interview with author, 5 August 2004; Derrick Msibi, interview with author, 20 July, 2004.

Transparency and Accountability

Exclusive management by the private sector is unlikely to deliver adequate transparency and accountability. Private investment managers report on their funds' financial performance, but have only recently begun to measure social impact. SRI fund management companies including Old Mutual Asset Management and Futuregrowth have created evaluation processes, including monitoring criteria, reporting methods, and external audits.[60] These mechanisms will need to be adapted to track outcomes and deliver independent assessments of the 5% Initiative.

Some members of government and business suggest that these mechanisms could also be modelled after the Financial Sector Charter, in which entities will be audited on their social investment and BEE goals. In addition, some members of the private sector would be comfortable with NEDLAC playing a role as a central monitoring point for tracking progress and identifying and addressing gaps. [61]

Representatives of business argue that institutions will have strong incentives to invest their 5%, due to the risk of losing funds from unions and government. [62] However, labour, community, and government will want stronger proof that a voluntary model will achieve the 5% target. Will there be deadlines? This model is basically no different from the current socially responsible investment process, which has not had an impact on significant under-investment in development. Thus proponents of the voluntary model will be hard pressed to prove that there is indeed increasing socially-targeted investment.

Local/ Community Participation

An advantage of the voluntary method is that it could build on emerging labour movement activism in the pension fund industry. Instead of relying on a new agency (social investment fund) or legislation (prescribed investment), trustees in pension funds could engage in shareholder activism and work with enlightened fund managers to change the financial sector from the inside.

Implementation Issues

The voluntary method has political and practical attractiveness to the private sector because it builds on the current SRI model. Labour and government may find this method too slow in achieving the 5% goal. In addition, a method that is closest to the status-quo may preclude creative investment vehicles that reach people in most need.

Investment managers and unionists alike point to the lack of knowledge about socially-targeted investment, and the resultant need for training of fund managers and pension fund trustees. Moreover, fund managers need to be reoriented toward focusing on social as well as financial returns. In short, this model could amount to little practical or rapid change. It will face the difficulty of generating collective action through volunteerism, all in the face of entrenched interests who oppose change.

4.2 Social Investment Funds

Description of Social Investment Funds)

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[60] Derrick Msibi, interview with author, 20 July, 2004; Lisa Christodoulou, interview with author, 2 August 2004. Futuregrowth has established an external SRI Committee which conducts site visits and debates investment issues.

[61] Cas Coovadia, interview with author, 5 August 2004; Elias Masilela, interview with author, 3 August 2004.

[62] Dennis Dykes, interview with author, 4 August 2004.

The first Social Investment Fund (SIF) was created in 1987 as a partnership between the World Bank and the Bolivian government. There is no universally-agreed upon definition as SIFs vary from country to country. However, economists at the World Bank propose that SIFs are agencies that finance small projects in several sectors targeted to benefit a country's poor and vulnerable groups based on a participatory manner of demand generated by local groups and screened against a set of eligibility criteria. [63]

SIFs are usually operated under a private business model, but work closely with the national government. In general, the SIF model fits well with the Washington Consensus approach to greater private sector role (rather than public spending) and the narrowly targeted initiatives. A key component of most SIFs is building on the abilities and resources of local communities and NGOs in order to leverage funding.

As of 1999, Public Works and Employment Projects (AGETIPs is the French acronym), a similar programme to SIFs, existed in 24 African countries. There is also regional network of AGETIPs called AFRICATIP. [64]

Transparency and Accountability

According to Jorgensen and Van Domelen of the World Bank, SIFs have a record in other countries of "strict accountability and transparency criteria through independent audits and intense public scrutiny." [65] However, the World Bank admits that SIF projects do not always target the poorest communities, because the funds want to show results.
In South Africa in particular, labour and government will want concrete plans for ensuring that an SIF will have a strong record of generating employment and alleviating poverty. [66] One way to focus a South African SIF toward these goals is to ensure that it is fully integrated with national policies for the reduction of structural poverty and unemployment. [67]

Local / Community Participation

The SIF model is based on local participation, both in generating demand for projects and in implementing projects. Local NGOs are tapped to implement projects.
However, SIFs in Latin American countries in particular have run into two major problems:

- Some communities simply do not have the capacity to express demand for a service or project
- As mentioned above, some of the poorest communities are not targeted for projects because there is a fear of failure.

Another problem may arise in that certain local groups may take too much control, marginalising others in a local community. Jorgensen and van Domelen of the World Bank propose potential methods that SIFs can use to better target the most marginalised local groups:

- reduce transaction costs by setting up regional offices,
- finance pre-investment technical support,

[63] Steen Lau Jorgensen and Julie van Domelen, "*Helping the Poor Manage Risk Better: The Role of Social Funds*," World Bank, Inter-American Development Bank Conference on Social Protection and Poverty, 1999, page 2.
[64] Jorgensen and van Domelen, page 7.
[65] Jorgensen and van Domelen, page 7.
[66] Devan Pillay, interview with author, 16 July 2004. Devan notes that the IDC has invested R 13 billion in the last 5 years and created only 158 000 jobs.
[67] International Workshop on Social Funds, May 1997 at the World Bank in DC.
http://www.un.org/esa/socdev/poverty/wb2.pdf

- provide resources for communities to mobilise and organise in order to express demand,
- offer a sliding scale of beneficiary contributions, and
- implement projects explicitly oriented to marginalised/vulnerable groups.[68]

Implementation Issues

A programme like an SIF or AGETIP might find popularity in South Africa. Stakeholders seem to support an intermediary between investors and bidders on projects. Moreover, Vusi Gumede (government), Jan Mahlangu (labour), and Duma Gqubule (BEE) all mentioned that all three constituencies should be involved in the implementation process. [69] Perhaps a South African SIF could operate with a NEDLAC-type board. Representatives from government, business, labour, and civil society could identify investment projects, which would be administered by technicians drawn from all parties as well.

As noted earlier, SIFs have a record in other countries of detailed performance measurement, including independent audits. If implemented in South Africa, the SIF would need to replicate this strong evaluation model. In addition, national government and other stakeholders would need to resolve what the balance would be between the SIF's independent management and sufficient integration with national government policies and programmes.

4.3 Prescribed Investment through a Defined Investment Universe

Description

This prescribed framework is similar to the "Invest for Growth Accord" recommended by the BEE Commission. [70] The model would require that the financial sector, government, and union pension funds allocate 5% of their assets to productive investments in "areas of national priority" over five to seven years. In consultation with all stakeholders, government would develop a list of investments – a "defined investment universe"—targeting these "areas of national priority." Individual investors would choose an investment from this defined universe, with government guaranteeing a minimum return (e.g. inflation + x).

The prescribed investment model could be managed by investment professionals based on the investment mandate negotiated by government, labour, business, and community at NEDLAC. National government, with input from all the relevant ministers and departments, would be expected to take the lead in ensuring that the process moves ahead. Labour, business, and community would also be integrally involved through a NEDLAC committee in setting guidelines for qualifying investment vehicles and evaluation mechanisms. This framework could be complementary to, and at the same time would draw from, the private sector's existing SRI framework.

There is much (white) business resistance to even the notion of prescribed investment, as there is to any active government intervention in the economy. Interestingly, prescribed investment is not new to South Africa. A very crude form of prescribed investment was even relatively popular among much white business during the Apartheid era. In 1956, the government implemented the Pensions Fund Act, which required financial institutions to hold not 5% but *50%* in government and prescribed stock (at least 10% of their total assets in government stock and another 40% in other prescribed stock). Such stock supported Apartheid and included National Defence Bonds,

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[68] Jorgensen and van Domelen, page 14.
[69] Vusi Gumede, Jan Mahlangu, and Duma Gqubule, interviews with author.
[70] BEE Commission, page 11.

Iscor, Sasol, water services, and homeland development corporations. Until the 1980s when the failing Apartheid state jeopardised financial returns, there was private sector support for prescribed investments, with many investors choosing to exceed the 50% requirement. [71]

Transparency and Accountability

A prescribed investment model would hold all institutional investors accountable to contribute toward socially-targeted investment. The list of investment options and the operation of government and NEDLAC administrative mechanisms would be available to the public to ensure transparency.

Local / Community Participation

Representatives of impacted groups and local communities would, if not in their own right then through their constituency representatives at NEDLAC, participate in the NEDLAC processes of (1) developing the list of investments, and (2) evaluating the social impact of investments. In addition, labour and community groups could help create investment guidelines and a training programme for pension fund trustees, to encourage financially and socially responsible decision-making. [72]

Implementation Issues

An implementation concern is that a prescribed investment model, being interventionist, would be unpopular with many in the private sector. Researchers at Fifth Quadrant also caution that if implemented quickly, prescribed investment could lead to a mismatch of supply and demand, and consequent problems of not enough capacity and poor returns. [73] To address this challenge, the BEE Commission suggested that in the implementation stage government could draw on the existing capacity of the private sector, such as fund management companies and the Business Trust. [74] However, the most crucial requirement would be for government to actively lead the process of identifying investment destinations.

5. CONCLUSION AND RECOMMENDATIONS

The 5% Initiative holds promise for boosting infrastructure and productive investment, and reversing poverty and unemployment trends. Participants in NEDLAC increasingly recognise that addressing poverty is not just about raising incomes, but also about enhancing assets and providing basic services. Investment can help poor people build enough assets to take on the risk involved in longer-term job searches, launching small business, and other economic activities.

Where to Invest the 5%? - Infrastructure and Productive Investments

NEDLAC parties are moving toward common ground regarding what types of investments to target. Economic infrastructure, low-income housing, and labour-intensive sectors seem to have the most consensus, with some support for SMMEs and education and skills training.

The best route here could be for the 5% Initiative to target a combination of infrastructure, housing and labour-intensive sectors such as job creating-greenfield investments and SMMEs. As these may be riskier investments, the 5% Initiative could create a "portfolio" that mitigates risk and return. [75] In addition, the 5% Initiative could be developed as a form of co-investment with

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[71] Ravi Naidoo, "Pension Funds: Investing in Growth and Employment," *NALEDI Policy Bulletin*, April 2003, pages 6 -7.

[72] BEE Commission, page 11.

[73] Eric Potgieter and Rustum Omar, "Socially Responsible Investments and Pension Fund Investment Mandates," Fifth Quadrant for NALEDI Pension Fund Research Paper Series, March 2004, pages 21-22.

[74] BEE Commission, page 12.

[75] For example, Futuregrowth's Infrastructure Bond Fund has investments varying from municipal bonds

government into infrastructure and productive investments. Government could offer appropriate guarantees to its co-investors.

How to Administer the 5%? - A negotiated investment universe

None of the three administration methods mentioned offer easy solutions, or are likely to draw complete and substantive consensus. The voluntary method may encounter problems with transparency and accountability and moving too slowly, if at all. The SIF model may not adequately target poor communities, and will have limited coverage. The prescribed method faces resistance from some business stakeholders.

Nonetheless, an "investment universe" model can be developed to combine some aspects of the other frameworks including flexibility, commitment, protection against excessive risk, and accountability. Indeed, the "investment universe" model has already been proposed by one government Committee of Inquiry, the Taylor Committee. In its report, "Transforming the Present - Protecting the Future," the Taylor Committee proposed that "retirement funds should be required to invest a proportion of their assets within a defined socially desirable investment universe." [76]

The proposed investment universe should include a range of potential investment options, the majority of which have a yield in line with market returns. In order to select the range of investments in the universe, government would develop draft guidelines to be finalised at NEDLAC. Investment projects could be based on nodal development strategies, vital infrastructure needs, and even strategic projects that benefit the country as a whole such as labour-intensive construction of stadiums for the 2010 World Cup.

Flexibility and choice would be preserved by allowing private sector fund managers to choose where among these options to invest. Commitment would be ensured in that institutional investors would put 5% of their assets into the defined universe. To protect fund members from excessive risk, government could implement co-investment or investment guarantees.
Transparency and accountability should be ensured through monitoring and evaluation by NEDLAC. The 5% Initiative should be coordinated by the Office of the Presidency in consultation with the four NEDLAC chambers covering Public Finance, Labour markets, Trade and Industry, and Development. In order to fulfil the joint goals of economic growth, job creation and other positive social impact, the Departments of Finance, Labour, Trade and Industry, Provincial and Local Government, and Social Development would also be closely involved.

Moving the 5% Forward – Additional observations

Government, business, and labour continue to have concerns about the 5% Initiative process. According to Cas Coovadia, the lack of consensus about how to administer the initiative could be an obstacle to finalising the process. [77] Some fund managers and business stakeholders worry that there may not be enough investments that meet both social return and financial return criteria. [78]
Stakeholders also have concrete ideas for how to improve the process. Suggestions include that the 5% Initiative should:

- Be coordinated with the NEDLAC constituencies and the Financial Sector Charter stakeholders,
- be guided by a comprehensive development strategy from government, and

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and roads, to universities, hospitals, and microlenders. Andrew Canter, interview with author, 2 August 2004.

[76] Taylor Committee, page 95.

[77] Cas Coovadia, interview with author, 5 August 2004.

[78] Andrew Canter, Derrick Msibi, Dennis Dykes, and Cas Coovadia, interviews with author.

- incorporate an exit strategy for investors (if an investment is not going well, it should be trade-able so the fund does not lose all of its invested money).[79]

At the same time, most people involved in the process remain optimistic. According to Jan Mahlangu, giving better direction to fund managers and training to trustees will ensure that change is possible. [80] Vusi Gumede believes that all these disagreements I'm optimistic can be overcome … ultimately there is a way forward … the fact that there was an agreement is a very important achievement, and it's going to be very hard for anyone to change that because the whole country is watching. [81]

Cas Coovadia agrees that there is a "coming together of minds across the parties," and adds that "in the next five years we can make difference."[82]

However, given the experience of low investment throughout the post-Apartheid era, stakeholder optimism by itself will not be enough to achieve a turnaround. Ultimately, stakeholders will look to government to demonstrate sufficient political will to address the problem of inadequate investment in growth and development – and give leadership to this process. Although this may be the case, it is the constituencies that have borne the brunt of low investment, labour and community that will have to engage government to assume this role.

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[79] Vusi Gumede, interview with author, 27 July 2004; Neva Makgetla, interview with author 15 July 2004; William Frater, interview with author, 2 August 2004.
[80] Jan Mahlangu, interview with author, 5 July 2004.
[81] Vusi Gumede, interview with author, 27 July 2004.
[82] Cas Coovadia, interview with author, 5 August 2004.

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