Pension Reforms, Capital Markets and Economic Development

Pension funds are a growing influence in our national economy -- despite their relatively small contribution in the capital formation through local listed equities (where pension funds investments in our listed equities is less than 10%) -- I believe the ongoing reforms and as more new and bankable IPOs come into play, the rate of pension funds investment in listed equities will eventually increase.

Historically, pension funds are important catalyst in the capital markets development in economies – mainly because of the long-term nature of their financial liabilities. While banks and other thrift institutions have liabilities that typically mature in a few days, at most, pension funds have benefit liabilities that, on average, may not mature for decades. As a result of this financial characteristics pension funds are a unique source of long-term capital for business and other such ventures of private and public nature.

I was recently invited to speak at the African Energy Forum in Istanbul where key players in the African energy, power and infrastructure assembled to discuss among other essential topics, the role of pension funds in Africa as alternative investment funds in key sectors such as energy, power and infrastructure. I noted that there has been general discontent among Africans in the continent about their role and taking a stake in the ownership of key sectors of their economies. So, to address these pots of discontent and for the purpose of peace, prosperity, and sustainable investments by foreign investors in such sectors – it is thought that pension funds, especially through the use of investment vehicles such as capital market (IPOs) or private equity or venture capital funds, may be the key source for investing pensioners' local term savings in such key sectors of the economy.

The extended part of the underlying argument is how can we device a mechanism that will reduce the seemingly discontent among Africans on how the concept of local content is being contexted. It seemed to me, from those discussions, that local content, especially the financing part, which is somehow left even in our own policy draft document is now being given a probable but serious consideration not only in local discussion but also by foreign investors and other players in natural resources, especially the extractive industry. We seem to all agree that for progressive and sustainable investments, tapping in local capital (small as is), architecting institutions and putting institutional frameworks: to dispense such mandates, improving welfare and prosperity of local citizens by way of economic inclusiveness (in its widest meaning) are inseparable. From this meeting I learned that discussions regarding local content, locals' economic empowerment and inclusiveness are now in consideration both in the corridors of power, policy and decision making bodies, the academia and in the main streets across Africa -- from Abuja, to Accra, Nairobi, Maputo, to our own Dar es Salaam, etc. The key question therefore was (is) how and in which vehicles and platforms can we facilitate implementation of this good idea? – among the other readily available and practical responses: pension funds reforms and capital markets development seems immediate.

However, I must admit that I was amazed and humbled to learn that such kind of discussions are being initiated in forums organized outside Africa and not by Africans, BUT a few of us (less than 10%) who were invited to participate and/or speak in this group of more than 1,000 participants (representing investors, bankers, private equities, hedge funds, contractors, suppliers and advisers) in the African energy and infrastructure projects. While in the platform speaking I broadly asked myself do we (African) recognize the importance and growing influence of capital markets and how can we use our contractual savings in the form of pension funds as a source of development investing in such key sectors?

So, the question is: how can we intensely the role of capital markets and pension funds (as institutional investors) in development finance and the economy in general? I wish my readers to note that I understand that there is a widespread perception, somehow backed by empirical observation that financial systems normally evolves through three natural stages of development – the first phase being bank-based financial system where banks are focal in financing private and public enterprises; the second phase is where capital markets comes into play and provide long term capital that is required for long term development projects -- projects such as manufacturing, commercial agriculture, extraction, infrastructure, power, etc and the third and final phase is to securitized phase where derivative financial products are engineered out of bank and capital markets based products, such and foreign exchange, money market, equity and debt instruments, and they get traded either in the informal markets such as Over the Counter (OTC) or in a formal organized market such as a Stock Exchange. Going by this natural cause, we may fairly argue that Tanzania, like many developing countries is still in the bank-oriented phase (as measured for example by indicators such as bank assets to GDP, private credit provided by deposit money banks to GDP, etc) – the key argument in this article is that how can we learn from others, or leap frog and use their experiences, accelerate the evolvement process, tap in long term sources of capital (through the use of capital market intermediation mechanisms) to facilitate local participation and eventually empower local citizens in the process of developing an economy that is more inclusive. Key sectors such as mining, gas, telecommunication, financial services, etc requires more local ownership involvement.

The argument here is not to quickly ignore the natural evolvement of financial system but rather I propel the idea that we become more mindful of the fact that we are operating in a global village where almost seven billion of its inhabitants are treated as if they have relatively equal chances of seizing existing and potential opportunities no matter where they are located in that village. People – either located in Istanbul, London, New York, Toronto, Sydney or Dar es Salaam have almost similar access to information about available opportunities and challenges in the Tanzanian mining, gas, telecommunication, banking sectors – what may be considered as factors separating us are quickly becoming imaginative. So, we may not have the luxury to go through a natural evolvement process of our financial systems because that might and probably is not work to our advantage.

After all in several cases capital markets development as measured by depth, liquidity, size, integration and volatility as well as banking development are related and they do supplement each other for economic development and sustainable growth. The capital (stock) market by facilitating long-term investment, may give rise to growth benefits to the economy that are not present with the shorter-term bank credit. In the mix of it pension reforms and growth of pension sector could have such an effect by developing institutions unwilling to be subordinated to domestic banks with strong appetite to long-term capital obtained from securities markets.

In my next columns relating to this topic I will try to indicate the causality relation between capital market and contractual savings such as pension funds and how can they be a catalyst to our economic development, especially enabling local participation and economic empowerment of local citizens and the whole idea of local content in key sectors of our economy.