Long Term Finance/Capital – A Key Challenge AND A Solution to our Sustainable Development

A good look into our economy, one will easily notice that there are mainly five sources from which almost all finances for investment activities in our country are ultimately derived from. The main sources of long term capital in our economy are: (i) household and institutions savings (partly supported by foreign/diaspora remittances – although not in a significant manner), (ii) Taxes, (iii) Foreign grants and loans, (iii) Foreign Direct Investments (FDIs), and (v) Foreign portfolio investors. Analysis of our financial system indicates that part of the mentioned sources of long term financing are intermediated through our financial system that include banks, microfinance institutions, pension funds, insurance firms and capital markets -- but a large part of long-term finance sources is not intermediated through the financial system and so raises questions as to what needs to be done? – Can the long term intermediation vehicles such as capital markets (stock exchange); development financial institutions (DFIs); private equities and venture capital funds be enhanced or strengthened or be made available and relevant into facilitate the financing of long term development projects such as: commercial agriculture, (value addition) light manufacturing industries for agricultural and agricultural related products, social and productive infrastructural projects, power projects, water facilities, etc?. How can this happen and who can make it happen?

According to UN National Data, Household and institutional savings is about 20% of our Gross Domestic Products (GDP) that in recent years our domestic savings rate ranges between 15% and 20% while our investment rate ranges between 28% and 32% of GDP. These data indicates that the statistical difference between domestic savings rate and the investment rate is accounted for by our country's ability to tap foreign (savings) investments to fill in this gap. Official loans and grants, which in recent years have amounted at least 30% of GDP per annum, represents the major reason why as the country we have been able to consistently invest much more than our ability to save – or tap into foreign savings to supplement the limited savings of the domestic system. Foreign direct investment, which in recent years has been in the range of between US$ 0.7 billion – 1.0 billion per year (4% of our GDP) also plays the key role in bridging the said gap.

As is, and looking into the short to medium term horizon: house hold and institutional savings, also foreign grants and loans as well as FDIs will continue to provide the foundation on which the long term finance of our development projects will rely on. However, we may need to note that in the medium to long term -- the structure, magnitude, composition and relative importance of the three key sources of long term financing for our long-term projects will change and realign. Domestic savings (emanating from both house holds and institutions), will continue to be relevant and commend most attention. However, the challenge remains as to how these savings will largely be intermediated through the financial system (i.e. through banks, microfinance, capital market (stock exchange)) -- compared to the existing situation? Available data indicates that financial intermediation in Tanzania is still relatively very low; banking sector penetration is less than 15% of the population, capital market usage for savings and investments activities is insignificant, i.e. less than 0.5% of the population!

Furthermore, over the medium term – levels of foreign aid, grants and multilateral or bilateral loans as measured in dollar terms will continue to decline. This is based on the new focus our country's relation with donor countries where we seem to be refocusing from aid dependency towards focusing into trade and investment partnerships. This being the case, FDIs and finances accessible through borrowing from both domestic and international markets will take a front seat.

This probable shift in the relative importance of FDI and borrowings from financial markets versus officials aids, grants and loans and the probable increase levels of FDIs and government revenues (especially from gas, and probably later from oil) in the medium to long term have major implication to our country's long term financing.

To add into the mix is the government's long awaited consideration of tapping long term debt financing to international markets (through issuance of a sovereign bond) to supplement the domestic bonds issuances – will this challenge the existing form and structure of intermediation, channelling and allocation of financial assets into the economy? Where will banks, pensions, insurance and other institutional and retail investors, who are accustomed to investing large part of their funds into domestic government issuances, invest their funds – will domestic savings be now allocated to the private sector which has ben (and is) in dire need of long term financing? is our capital market framework, products and infrastructure able and capable of tapping these funds and direct them into productive investment sectors of the economy for sustainable development?

Can the flow of local private long term financing into the sectors such as manufacturing, commercial agriculture, real estates, oil, gas, and other minerals such as coal and iron ore be made possible? can reforms in the pension sector and housing finance enable availability of long term financing to be directed into some of these key sectors of our economy? Can we continue to rely almost whole on the FDIs to drive these sectors while large part of our domestic savings are directed towards short term investments such as providing working capital for traders and service providers through the commercial banking system? which do not any way facilitate growth of social infrastructure, productive infrastructure, power supply, water supply, manufacturing activities, agricultural and agriculturally-related activities, better housing and livelihood, etc.

Lastly, we have the challenge of intermediation of existing long term of funds into our economy – being domestic (households and institutional) savings, official (donor) grants and loans, foreign direct investments and/or foreign portfolio investments either do not get properly channelled through the financial system at all, or do impact the financial system only in a marginal manner. Most of these funds sources get transmitted from their initial sources to their eventual users without any significant involvement of our financial system and where the financial system is involve as a channel, that will be through the banking system because as it is we are predominantly a bank-based financial system. Can the capital market become relevant in this process?

Reliance on banks for intermediation in our financial system, however, has not prevented the financial system from growing, indeed the banking sector assets have expanded rapidly from about TZS. 1,500 billion in 2000 to more than TZS 20,000 billion as of December 2013, about 45% of GDP. But this high rate of growth has been led by the growth of private sector deposits in the banking system and has not fundamentally reduced the bank share of total financial intermediation and channelling of funds. On the other hand our capital market (Stock Exchange) have been used to intermediated/raise capital amounting less than TZS1,000 billion in form of shares and corporate bonds. The domestic market capitalization is now at TZS 6,100 billion, about 12% of the GDP.

Since, presently banks dominate our financial system, then is it not safe to argue that short term financing dominates over long term financing?. If this is true, then where does the funds for financing infrastructural project, support of PPPs, financing of power projects, financing of commercial large scale projects and financing of manufacturing projects come from?

Domestic house hold savings?, Taxes? Or FDIs and foreign grants and loans? Small as they may be BUT why can't domestic savings within pensions, insurance, firms and private individuals be properly managed and intermediated through long term intermediation channels and be utilize to finance long term development projects, both in the public and private sectors of the economy?