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Building East Africa's Future: Tanzania and Accelerating Infrastructure Growth
Insights from the U.S. Africa Leaders Summit

By Moutusi Sau with Olivia Bell

At last month's U.S.-Africa Leaders Summit, the White House brought together government officials from 50 African countries. The historic gathering in Washington focused on trade and investment in Africa, drawing scores of investors and American business executives. During the summit, we had the opportunity to attend these two events: the Milken Institute's Corporate and Investor Roundtable, and Doing Business in Tanzania, organized by the Corporate Council on Africa.

The roundtable gathered leaders in the business and governance community, while Doing Business in Tanzania addressed that country's focus on investing in infrastructure. In this white paper, we explore the importance of infrastructure in the growth of East African countries, the role of pension funds in infrastructure development, the emergence of a new East African bloc, and the emerging role of Tanzania in East Africa. We found compelling arguments for the tremendous potential of the East African Community (EAC) if Tanzania were to become more active member. Looking at the success of pension funds stimulating infrastructure growth in Chile as well as examining current prospects in the EAC countries, it has become apparent that a well-connected EAC could lead to exceptional economic opportunity.

Infrastructure: Building Blocks of Success

At the Milken Institute roundtable, participants expressed how infrastructure is integral to the growth in Africa, and stressed the importance of electricity, ports, and transportation systems. A study conducted by Calderón in 2008 found that deficient infrastructure could sap economic growth by as much as 2 percent a year. In East Africa, infrastructure has been identified as the single-largest impediment to the region's ability to compete with other developing countries. According to World Bank statistics, the current road-access rate is only 34 percent, compared with 50 percent in other parts of the developing world. At the Doing Business in Tanzania conference, Jean-Louis Warnholz, founding principal and managing director of Black Ivy Group LLC, identified the lack of electricity as the greatest barrier to infrastructure expansion. Only 30 percent of the African population has access to power, in contrast to the 70 percent to 90 percent of the population in the rest of the developing world. To support increasing urbanization and industrialization, the EAC would have to increase production of electricity by approximately 5.3 percent per year until 2020. This means generation capacity would have to increase by 37.7 percent in Uganda, 96.4 percent in Kenya, 75.3 percent in Tanzania, and 115 percent in Rwanda.

Wealth of energy resources

Despite the electricity-related challenges, the EAC holds vast potential within Africa for growth in infrastructure. The EAC countries have significant, untapped diverse energy sources. Tanzania has natural gas, coal, geothermal energy, biomass and wind, and the government is looking to outside investors to unlock the potential of these resources. Tanzanian President Jakaya Kikwete, along with other panel members at the conference, pointed out the country contains a potential 50.5 trillion cubic feet[1] of natural gas reserves. This is the largest amount in East Africa when compared with the merely 6.5 billion barrels of potential natural gas reserves in Uganda.[2] Tanzania is merely waiting for the money and initiative from outside investors to tap into this potential. In Kenya, about half of the energy generated is from hydroelectric sources. Its government is planning to exploit geothermal sources like coal and oil, and wind-powered plants to counter the hydro-dependency. Kenya has used only 200 MW, which comprises about 3 percent of the total geothermal potential available, and has plans to expand to 5000 MW by 2030 for a minimum investment of $18 billion.

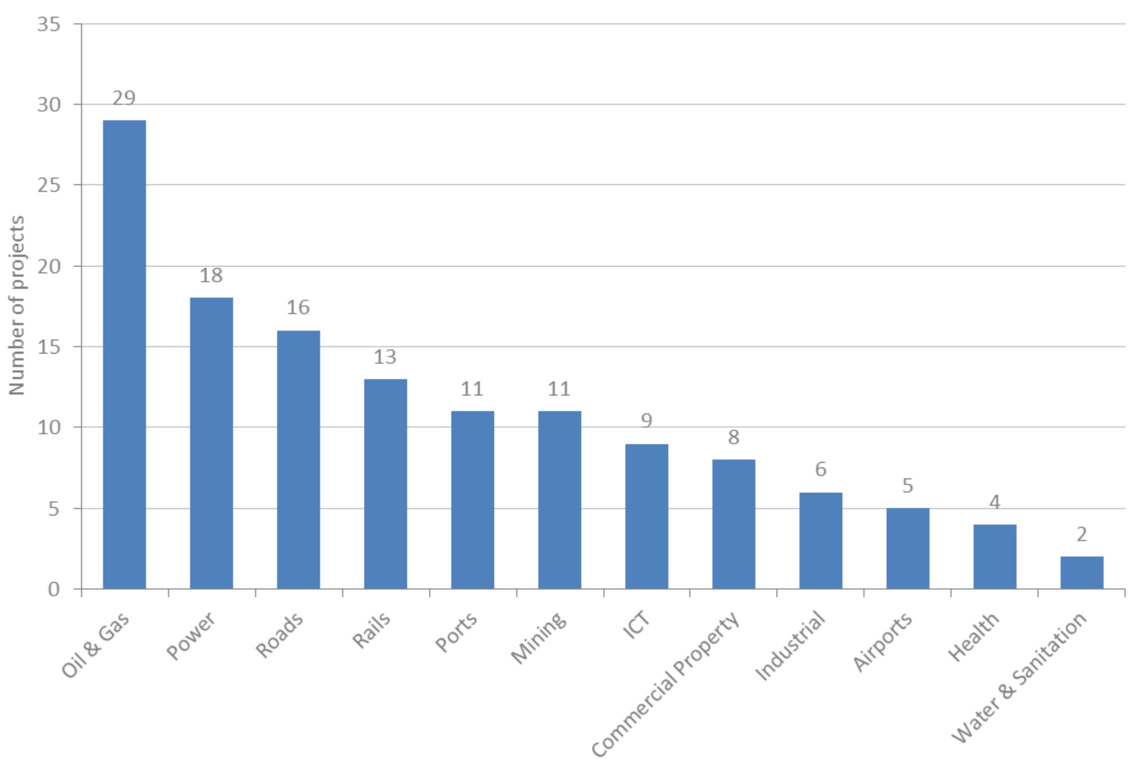
Developing regional connections

These abundant potential resources are an excellent opportunity for commercial and infrastructure development, but they need to be supported by a network of regional infrastructure. Experts agree that EAC countries working together have a significant advantage in attracting investments into the region and that these countries surprisingly have been making good progress in recent years in regional infrastructure development. At the Milken Institute roundtable, participants mentioned that considerable steps have been taken to strengthen the partnership between Rwanda, Uganda, and Kenya. The three nations are undertaking a series of joint projects and initiatives to integrate economic, political, and trade infrastructures. One project announced recently is the creation of a joint railway line among these countries that will promote interdependence and trade in East Africa.[3] The collective integration of these countries offers several benefits, including speeding up processes and mitigating risks by investing in joint infrastructure, cutting down on transportation time from 22 days to six days, and facilitating business and entry visas. The three countries have also agreed to develop a crude oil pipeline and refinery. Uganda and Kenya are jointly spearheading the efforts for the pipeline, which would run from Uganda to Kenya, linking South Sudan.

Absent from these collaborative efforts is Tanzania, which has sidelined itself on many of the initiatives that have been undertaken to strengthen the EAC as a group. For instance, Tanzania was not a part of the conversation when Rwandan, Ugandan, and Kenyan leaders gathered in October last year to discuss the creation of a regional railway transportation corridor.[4] While Tanzania remains politically close to these countries, its focus on domestic expansion has left it behind regionally. Tanzania has been dragging its feet on several EAC integration issues because of their differences in opinions in several important issues. Tanzania had concerns in the past because of differences in the various EAC economic systems regarding land ownership issues, political federation and citizenship. So what does this mean for Tanzania? If Tanzania wants to have a greater say in these conversations, then it must become an active member in this community.

Tanzania would benefit greatly from stronger ties with the other EAC member countries because it would increase trade and other connections. Tanzania's largest port, Dar es Salaam, holds immense opportunity for opening the doors to trade and Africa's interior. Dar es Salaam is the fourth-largest trading port in Africa, and East African countries have plans to boost cargo volumes by 80 percent in the next two years. To enable this ambitious growth in cargo volumes, the Tanzanian government earmarked $1.5 billion to upgrade existing facilities and improve efficiency. This investment is sorely needed. Dar es Salaam faces stiff competition from its closest competitor, Mombasa, Kenya, which gets high marks for efficiency and transit times. To compete with Mombasa, Tanzania must be better connected to its interior. Currently, with few paved roads and railway transport connecting the major ports, expansion and continuation into the interior is difficult. According to the World Bank, Tanzania is currently working on infrastructure development project with an investment of $213 million from the World Bank Group and $6 million from the Danish government. This infrastructure project is targeting 23 dirt roads (7.23km in total) around Tanzania's fastest-growing Tanzanian city, Arusha, and will pave and provide electricity to them[5].

Figure 1: East Africa's infrastructure projects, by category, January 2013 to August 2014



Source: Africa Project Access; Milken Institute.

Chart 1: East Africa's infrastructure projects, by country, January 2013 to August 2014

Country	Number of projects	Percentage
Tanzania	49	37%
Kenya	40	30%
Uganda	20	15%
Rwanda	15	11%
Burundi	8	6%
	132	100%

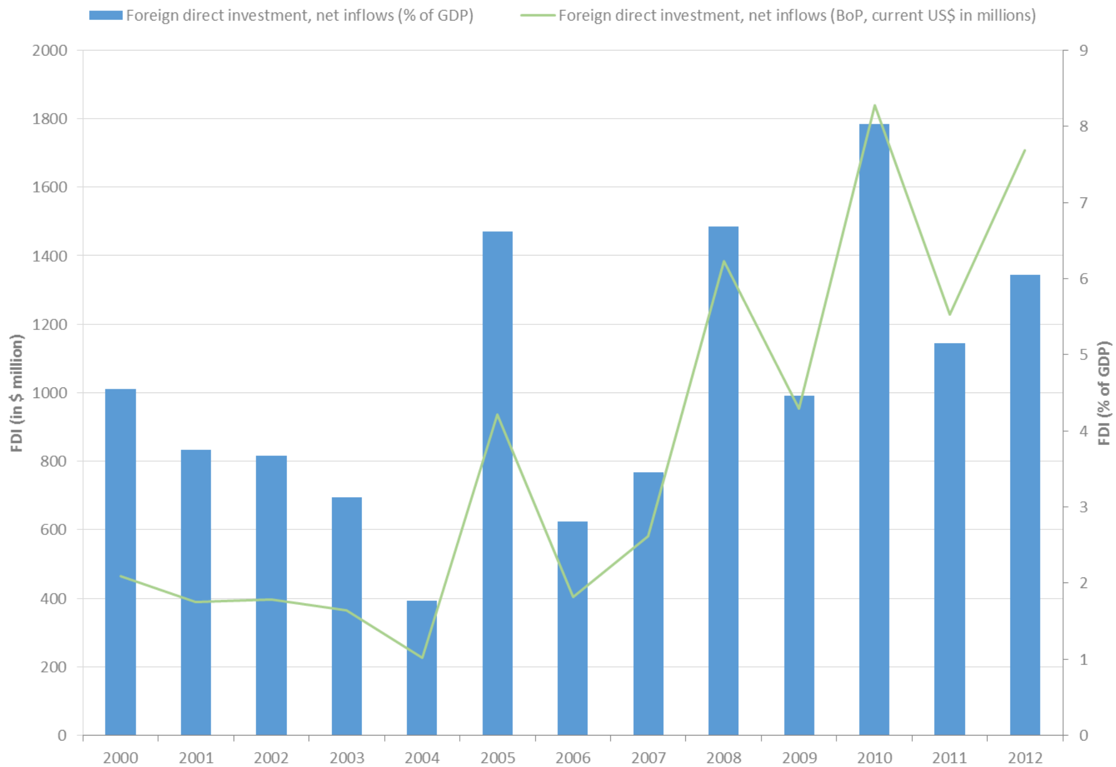
Source: Africa Project Access; Milken Institute.

Another way to improve Tanzania’s competitive edge is to improve its transport connections with the neighboring nations. This is where the African Development Bank (AfDB) is making its biggest effort. The AfDB is currently funding 126 projects worth $4.1 billion.[6] Seventy percent of this total has been devoted to infrastructure, with $1.3 billion specifically for transportation connecting these countries.[7] The improvement of roads and railways connecting the Tanzania will significantly increase efficiency and possibilities for investors in this region.

Tanzania’s Potential as a Key Player

The relationship between Tanzania and EAC is mutually beneficial. Tanzania has a geographically strategic advantage and stable economy, and is the highest recipient of foreign direct investment (FDI) in East Africa. Given its long coastline with the presence of Dar es Salaam, it is an active trading hub—a plus for Tanzania’s relationship with the bloc. Moreover, with its economic growth at nearly 7 percent this year and inflation stabilized in the single digits at 6.5 percent,[8] Tanzania along with its counterparts in the EAC are no longer wild cards for companies. Investors have started noticing, as indicated by FDI since 2000 (Figure 2). Tanzania is one of the leading recipients of FDI in East Africa at $12.7 billion (December 2013).[9] China and the United States are the leading investors in East Africa’s second-largest economy. In 2013, China contributed $1.4 billion, and the U.S. invested $950 million. If the countries put in the effort to work together, they can kick-start their economic potential.

Figure 2: Foreign direct investment in Tanzania



Source: World DataBank, World Development Indicators, Milken Institute.

To make this happen, as pointed out by the participants during the Milken Institute discussion, the governments need to stress the importance of reliability, openness towards infrastructure investment, and willingness to work together. The focus of the EAC governments should be to provide a platform for both public and private sector participants to engage. The governments should make a firm commitment to openness and good governance that will instill the faith in private sector participants to participate in investing in infrastructure.

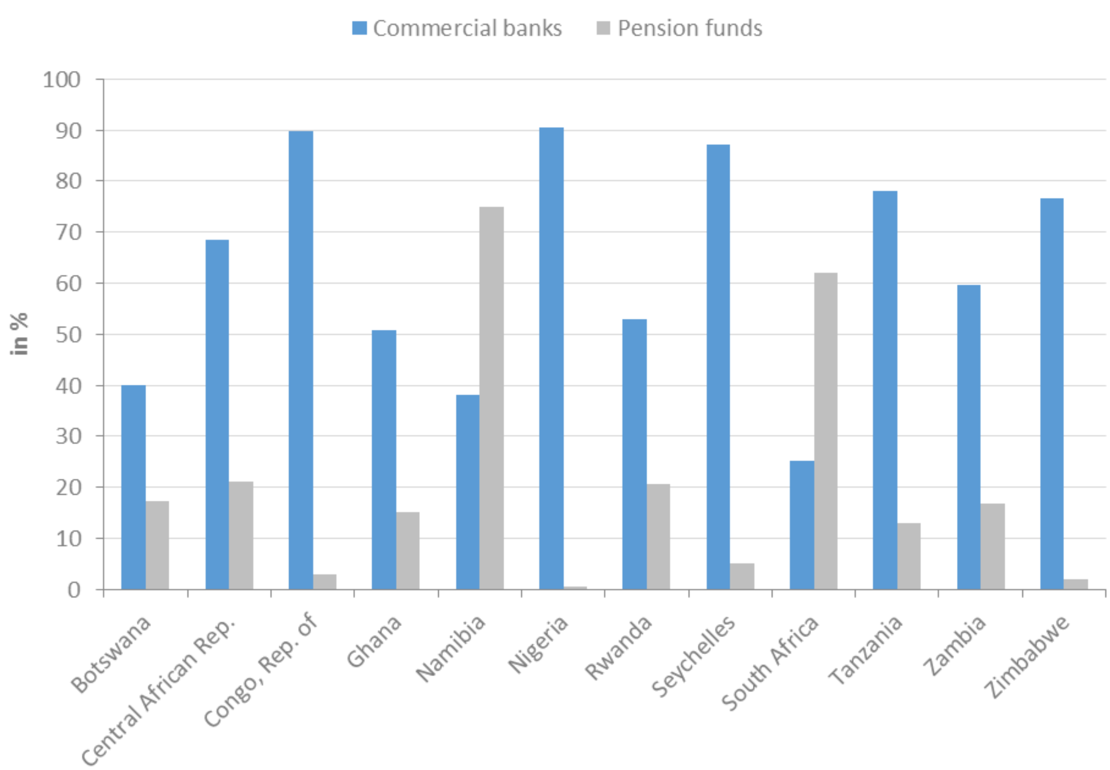
Model Funding: Chile's Private-Public Partnerships

Chile has a successful record of accomplishment in public-private partnerships. Its infrastructure concession legislation embodies good governance that explains a lot of the success. The EAC has much to learn from this example.

Moreover, Chile is an excellent example of marshalling capital markets to channel local savings into their infrastructure investment. Chile's pension funds are one of the most liberal and oldest in Latin America that allows investments in infrastructure. The national pension board, called the National Public Investment System, has been exemplary in improving the efficiency of its capital spending by standardizing procedures for investing in infrastructure. From a financial standpoint, infrastructure's inherent characteristics that include steady yield, low volatility, and long duration are an excellent match for pension fund assets.

There is an opportunity for pension funds in Africa as well. Pension funds are already the second-largest lenders in infrastructure in Sub-Saharan Africa after traditional banks—especially in Kenya and Rwanda.[10] According to a survey conducted by Emerging Markets Private Equity Association (EMPEA), pension funds of 10 African nations including Rwanda and Nigeria, have approximately $29 billion[11] in total assets available for investments into various asset classes. Additionally, the African pensions industry has the potential to expand in the near term. Nigeria's retirement funds have experienced extraordinary growth, and the industry has almost tripled in size in the past five years, to $25 billion in assets with a participation rate of only 10 percent. A study conducted by Renaissance Capital projects that by 2020, Sub-Saharan Africa's six largest pension funds would have assets of $622 billion. Currently, these pension funds invest mostly in domestic debt that is short-term in nature with an average maturity of 231 days. However, with future availability of the large pool of assets, it will be imperative for the industry to come up with a plan for channeling these investments into long-term assets. Infrastructural project financing offers the perfect solution.

Figure 3: Financial holdings as a percentage of national assets, 2012



Source: IMF, Country Profiles, Milken Institute.

Again, Chile offers a model for attracting foreign investors in the infrastructure space. Foreign investors are beginning to pay attention to East Africa. However, infrastructure is a difficult match for foreign investors for several reasons. The lack of performance tracking and relevant data for infrastructure makes investing in these assets very challenging. Moreover, lack of benchmarks like Internal Rate of Return and Investment Multiples in these asset classes is a formidable challenge to invest in infrastructure. Nevertheless, Chile is a trailblazer for other nations in this space. The participants shared their experiences at the Milken Institute roundtable, on investing in Chilean infrastructure. In 2008, OTPP invested about $887 million in Grupo SAESA, Chile’s second-largest electricity distributor. In 2007, OTPP bought Aguas Nuevo Sur Maule SA, a major water-supply company. As evidenced by the Chilean model in infrastructure investment, foreign pension funds can also play a large role in East African countries with good governance and strong capital markets. International pension funds can provide an important source of capital for infrastructural development, a sector that has been dominated by official aid and direct investment largely from resource companies.

Conclusion

If East African countries hope to become the next biggest investment destination, they need to have in place the infrastructure and governance structure that can support incoming investment and trade. Therefore, closing the infrastructure deficit is critical for economic growth and sustainable development. The EAC countries—Kenya, Uganda, Rwanda, Burundi and Tanzania—hold bright futures for their people and the global economy, but cooperation and co-integration are keys to achieve that dream. A regional integrated bloc approach would give them the collective presence and cost advantage that would be hard to dismiss. Investors have recognized the potential, and there is much reason for optimism in their future. Slow yet meaningful steps are being taken in this direction. Across this region, countries have to explore the path of cross-integration that can be beneficial for all members in East Africa.

Endnotes

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About the Authors

Moutusi Sau is a program research analyst at the Milken Institute's Center for Financial Markets in Washington, DC. Her research expertise is in the areas of financial institutions, international finance, and capital markets development in developing countries. She helps execute programmatic activities on policy research, program management, and communications activities. Her recent Institute studies include "Capital Markets in Developing Countries: The State of Play." Sau is a regular contributor to the chart of the week section in Institute's latest microsite: globalbanking.org, a one-of-a-kind platform for accessing information on banking systems and banking regulation worldwide. Prior to joining the Institute, Sau worked at Durham Capital, where she sourced senior and junior debt-financing opportunities and business development for mid- to large-cap public and private companies worldwide. She has worked with companies based in North America, South America, Europe, and Australia. She specialized in financings in oil and gas, metals and mining, and real estate. Before her stint at Durham, she was an associate in global equity research at UBS Investment Bank. She holds an M.S. in investment management from Boston University and an MBA in finance from India.

Olivia Bell is a senior at the Milton Academy, in Milton, MA. In the summer of 2014, Bell was an intern at the Milken Institute's Center for Financial Markets, where she conducted research and helped execute programmatic activities on capital markets development in developing countries.