PENSION FUND INVESTMENT IN ETHIOPIA:
OPPORTUNITIES AND CHALLENGES
(A CASE OF ETHIOPIA SOCIAL SECURITY AGENCY)

Prepared By: Mengistu Gebru

Advisor: Abebe Yitayew (Asst. Prof)

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**Statement of declaration**

I, the undersigned, declare that this project is my original work and has not been presented for a degree in any University, and that all sources of materials used for the project have been duly acknowledged.

**Declared by:**

Name:  ---------------

Signature:  ---------------

Date:  ---------------

**Confirmed by Advisor:**

Name:  ---------------

Signature:  ---------------

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Place and Date of Submission:  ________________________________
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ACRONYMS

1. **ESSA** - ETHIOPIA SOCIAL SECURITY AGENCY
2. **ILO** - INTERNATIONAL LABOUR ORGANIZATION
3. **RLDS** - REGIONAL AND LOCAL DEVELOPMENT STUDIES
4. **BPR** - BUSINESS PROCESS RE-ENGINEERING
5. **AAU** - ADDIS ABABA UNIVERSITY
6. **FBE** - FACULTY OF BUSINESS AND ECONOMICS
Abstract

In this paper it has tried to gather the opinions of different scholars about the opportunities and challenges of Pension Fund investment in Ethiopia. Accordingly, 98.87% of them said there will be investment opportunities in Ethiopia for Pension fund in the Future. Globalization, better and liberal investment policy of the government and the hope of stock exchange market establishment in the near future are some of the reasons forwarded by the respondents. They also said, high government intervention, problem of accessing capable professional, and lack of clear investment guidelines, policy, strategy, mission and objective are some of the challenges to be faced by the agency in the future regarding pension fund investment.
CHAPTER ONE

Introduction

1.1 Background of the Study

Pension funds may be defined as forms of institutional investors, which collect, pool, and invest funds contributed by sponsors and beneficiaries to provide for the future pension entitlements of beneficiaries (Davis, 1995a). They thus provide means for individuals to accumulate saving over their working life so as to finance their consumption needs in retirement, either by means of a lump sum or by provision of an annuity, while also supplying funds to end-users such as corporations, other households via secured loans or government for investment or consumption (Davis, 2000).
The pension funds are among the largest institutional investors in the developed countries. For example, the 20 largest pension funds in the U.S. hold about 1/10\(^{th}\) of the equity capital of publicly owned companies in the U.S., institutional investors controlled 40% of the common stock of the country’s large and mid size businesses, and pension funds held about 40% of the medium and long-term debt of the largest companies showing that “these institutional have become corporate America’s largest lenders as well as its owners” (Drucker, 1996).

Now-a-days, pension founds participate in financial intermediation. According to Davis (2000), pension funds are analyzed as financial intermediaries. Their growth complements that of capital markets and they have acted as major catalysts of change in the financial landscape.

The African social security institutions have grown and their contributions to national economy have become more significance. As a result, the subjects of the investment of the assets of social security institutions have become topical (Musege, 1997).

As Musege (1997) said, even though the Africa’s social security institutions investment activities are growing, they are surrounded by many constraints like inadequate legislation on investment, government intervention, undeveloped capital markets, lack of fund management skills, the problem of monitoring, lack of rating agencies for corporate bonds, etc.

In Ethiopia there is pension fund contribution by employees of organizations (i.e. government sectors). It is worth investigating how fruitfully this fund is being used by employers before releasing it to the respective beneficiaries. However, the cardinal of this
exercise is to unravel the facts regarding how effectively the pension fund is managed by those responsible of custodianship of the same.

1.2. Problem Statement

The social security organizations collect contributions in order to carry out their mandate to provide benefits and to build up reserve funds. The current financial practice is to invest funds that are not immediately needed and try to obtain the best possible rates of return (Ahmadou Yeri Diop, 2000).

The Ethiopian social security Authority was established with the objective to “strengthen and expand social security programs” in the country. It had given the authority to invest the social security funds in “profitable and reliable investment activities” and to own property (Proc. No 38/1996). The authority was re-instituted as an autonomous federal agency having its own juridical personality to enable it to perform its duties efficiently and hence its name is changed to the “Ethiopian Social Security Agency” (ESSA). It has given the power and duty to invest the social security fund in profitable and reliable investment activities (proc. No 345/2003). As a result the “Social Security Agency investment office” is instituted to handle the investment activities. The agency is financially capable to invest. That is, there is idle cash to be invested, and the agency has given the power and duty of investing the fund.

Thus, with this in mind, the paper is going to address the following questions:

1. Is there pension fund investment policy and guideline?
2. Does the agency have an investment strategy?
3. What is the objective of the pension fund investment?
4. Does the agency have the capacity to handle the funds as per its choice of investment?

5. Is there an opportunity for pension fund investment in Ethiopian without an organized stock exchange market?

6. Does the agency have fund manager/s who can administer effectively and efficiently the pension fund investment?

1.3. Objective of the Study

General Objective:

The general objective of the study is to investigate the opportunities and challenges of pension fund investment in the Ethiopian context.

Specific Objectives

Specifically, the paper is designed to:

- Identify the investment opportunities available in relation to the capacity.
- Identify factors hindering the pension fund investment.
- Investigate the challenges faced by the pension fund investment office.
- Critically assess the investment policy and guide line of the Ethiopian social security agency.
- Provide valuable suggestions and recommendations based on the findings.
1.4. Significance of the Study

If the aforementioned objectives are met, the paper will have the following importance:

1. It may be used as an input for ESSA investment office for future investment activities.
2. It may show the challenges and prospects of pension fund investment development.
3. It will give information about the pension fund investment to the public.
4. Other researchers may use it as a relevance source for further study.

1.5. Methodology of the Study

Data Source:

In order to accomplish the then mentioned objectives, both primary and secondary source of data are used.

Primary source:

The primary source of data is obtained from semi-structured interview and questionnaire.

- Interview has conducted with the manager of the ESSA investment office.
- Questionnaire was distributed to academic staffs of AAU-Accounting and Finance department, to selected 2009 prospective graduating Msc in Accounting and Finance students, Bankers, present and former staffs of the ESSA, to some employees of the Ethiopia and Addis Ababa Chamber of commerce, to some employees of the Ethiopian Commodity Exchange Authority, and to some employees of the Ethiopian Institute of Development Research. The samples are
selected based on Judgmental sampling technique. This is because individuals with better information can give better information.

**Secondary source:**
The secondary data is collected from the Negarit Gazzetas, and other relevant literatures.

**Data analysis and presentation**
The data is summarized using simple descriptive analysis and presented in tabular form as necessary. This involves describing the opportunities and challenges of pension fund investment using data obtained from the primary and secondary sources. In addition, comparison is made with some African countries practice.

**1.6. Limitation of the Study**
The study has got critical limitations due to the following reasons.

⇒ The agency has no clear and organized secondary data regarding the pension fund investment (like guideline, strategy, policy, mission and objective).

⇒ The area is new, have limited practical experience and the public has limited awareness on its management. This makes difficult for obtaining appropriate and representative sample.

⇒ It is impossible to see the higher officials of the ESSA for interview and discussion.

⇒ Had there were financial capacity and time, the comparison of pension fund management with African countries would have been on primary data basis through interview, questionnaire and physical observation from some the countries.
1.7. Organization of the Paper

The paper is organized and presented in four chapters. Chapter one is about the introduction of the paper. It contains the background of the study, the statement of the problem, objective of the study, methodology used to accomplish the objectives, the significance of the study and its limitations. Chapter two contains reviews of related literatures; chapter three presents brief background of the Ethiopian Social Security Agency; chapter four contains the analyses and presentation of the data collected from primary and secondary sources, and the last part, chapter four contains the summary, conclusions and recommendation forwarded based on the findings.
CHAPTER TWO

Review of Related Literatures

2.1. Features of Pension Funds

The dictionary definition of pension is “money that is paid regularly by a government or company to some body who has stopped working because of old age or who can not work because they are ill”. And Fund can be defined as “sum of money that is collected for a particular purpose.” So, we can define pension fund as sum of money collected by the government or a company for the purpose of repaying to those who has stopped working because of old age or who can not work because they are ill. As can be understood from the above definition, the pension funds can be collected and managed by the government (publicly managed pension funds) or by a private company (privately managed funds). Some times hybrid pensions are also existed.

Pension funds are collected at the early age (working age) of employees and will be repaid at retirement age. Hence, those who are responsible to manage the pension fund have long-term liability- they collect early and paid later. This gives chance for investing these pension funds. According a report by international Labor Organization (ILO, 1997), effectively managed pension funds can have a considerable influence on the national economy and national capital market.
E. Philip Davis (2000) has noted the following key features of pension funds:

1. Since early withdrawal of funds is usually restricted or forbidden, pension funds have long-term liabilities, allowing holding of high risk and high return instruments.

2. Risk pooling for small investors, providing a better trade-off of risk and return than for direct holdings,

3. Ability to absorb and process information, superior to that of individual investors in the capital market.

4. Large size and thus economies of scale, which result in lower average costs for investors.

2.2. General Principles and Considerations for the Investment of Pension Funds

Pension funds are among the largest institutional investors that contribute badly to a nation’s economy. Because their reserves are a considerable amount, even may reach up to 50% of a country’s GDP.

So, investment of this tremendous amount of fund is as important as to the national economy by reducing unemployment, increasing GDP, improves living standard of the old-aged people and so on.

As written by the international labor organization (ILO, 1997), it must not be forgotten that these funds represent property of others, that is of the insured persons and their
dependents. As a result, the management of the funds has to be handled according to certain well-defined principles and considerations.

1. Safety, Yield, Liquidity and Utility Considerations

The managers of pension funds have fiduciary responsibility to those contributors. The money is going to be paid by tomorrow. Therefore, the safety of the investment vehicle (from being bad debt), optimum return and being liquid while beneficiaries are authorized to receive should be considered critically. In addition, these funds should also respond to socio-economic issues (i.e., health, education, and living standard of insured persons), when investment is made.

2. Clarity of Objectives

While investing social security funds, there should be clear and obvious purposes. Establishing clear objectives provides as a benchmark in measuring the performance of the social security fund investment.

According to Tamagno (2000), the following may be included as objectives of social security fund investment:

- Promoting domestic savings and investments
- National economic and social development.
- Financing part of public sector debt
- Participating in Ethical and socially responsible investments.

4.2.2 Independence from Political Interference

Sometimes it has been seen that governments tried to use the social security fund for short-term political purposes as their size is a considerable amount.
“In order to invest effectively, the managers of a social security of fund must be confident that they can make investment decisions which conform to the established objectives of the fund and which are backed by sound investment analysis, without the risk of political second-guessing interference (Tamagno, 2000). Of course, independence does not mean not being responsible to respective parities.

8. Accountability to Insured Persons

The pension fund is the money of others (who contribute in their early stage for the expected compensation during retirement). Therefore, in order to develop the confidence of the contributors, pension fund investment programmer has to be accountable to respective bodies (i.e. Government, employees, and employers). It can do this by enacting annual reports and investment board’s policies to the public.

9. Sound Governance

The policies, strategies and performance of an organization is a reflection of the organization’s governance level. Hence, governance deals about how a company is managed at its top level and how strategic decisions are passed and implemented.

Tamagno and Musenge (2000) wrote, the following as components of governance:

- The mandate and role of board of directors,
- The process by which the members of the board and the officers and selected and their performance evaluated.
- Process and structure of planning and decision making
- The measurement of the organizations performance, etc.
10. Prudence in Investments

Since the pension fund is the money of the insured persons contributing it, the managers of the fund should act in the best interest of them. They should avoid undue risk and possible conflict of interest.

2.3. Instruments for Investment of Pension Funds

According to ILO (1997) report, the principal financial instruments for investment of social security funds which may be available include:

1. Loans (fixed income securities)
   A. Government securities
   B. Securities issued by statutory corporations or other bodies which are guaranteed by a government.
   C. Corporate bonds
   D. Mortgages (loans, normally secured by real property)
   E. Bank deposits yielding interest.

2. Equities
   • Shares (ordinary and preferred)
   • Real estate (physical property).

2.4. Governance of Pension Funds

Pension funds are collected by the government or a company with the intention of repaying the money sometime in the future to the contributors of the fund. Hence, the contributors are the principals and the government or the private company is the agent which is managing the fund until the contributor is retired.
The principals (pensioners) cannot directly manage their fund rather the agent is responsible to administer. The agent may not behave in the best interest of the principal and may divert the fund to its interest. For example, government may put the money for its short-term political purpose, a considerable amount of the fund may be invested in government treasury bills with lower returns while it had got higher return if invested in corporate bonds and stocks and other instruments. Due to this and other reasons there may be agency problems. The agent (who collects the fund) may exploit the fund towards its interest ignoring the safety, yield, social and economic utility, and other considerations.

According to Tamagno (2000), governance encompasses the management of the organization as a whole by the most senior management and the strategic implementation practices.

As Ambachtsheer (2007) quoted the 2006 study of Ambachtsheer, Capelle, and Lum, “High-quality governance funds out performed low quality funds by about 2% per annum. The study also indicates as there was a positive correlation between proxy metrics for pension fund governance quality and for pension fund performance.”

According to Ambachtsheer (2007), the biggest pension funds have about $25 trillion accumulated pension assets, but the challenge still is many pension funds around the world continues to be raise their governance game only from bad to better (no best), and that bad governance practices have an economic cost.

Ambachtsheer (2007) also quotes in his study the message of peter Brucker, Elliott Jaques, and John carver about the issues of the agency problem:
“Addressing the agency problem needs us to designing pension fund governance structures responsive to stakeholder needs. The essence of their message is that organizations cannot function on good intention alone.” Therefore, the following has to put clearly:

- The purpose of the organization
- The role of the board and its accountability to the organization’s members/stakeholders/owners.
- The need for clarity about what the board does (e.g. defines, delegates, and monitors) and does not do (e.g. performs operational tasks).
- The need of the board to act as a collective body, speaking with one voice to define its expectations, assigning these expectations to a chief executive chosen by the board, and then checking that they are met.
- The role of management as the initiator, and with board approval, the implementer of strategic and operational plans required for the organization the board’s expectations.

2.5. Relevant Organizational Requirements

1. Mission and Goals

Johnson (1998) quoted one smart sentence of Theodore Levitt which said “if you don’t know where you are going, any road will take you there”.

The basic message of the above quotation is that, unless a company has clear mission and goals to be achieved, it will be too difficult to take meaningful decisions and actions. And the survival of that organization in this globalize world will be in question. (Johnson, 1998)
2. Policy
The top management’s overall future direction of the organization should be put in policy statement. The policy statement at the top level will be clarified and complemented by objectives. (Leontiades, 1982)

3. Strategy
According to Leontiades (1982), strategies answer the question how does the organization intend to get where it wants to go.

4. Plans
Plans provide the detail of a strategy, and assistance facilitating or retrained successful accomplishment of objectives. (Leontiades, 1982)

2.6. Some Countries Experience of Administering Pension Funds

Investment

1. African Case
As written by Ahmadou Yeri Diop (2002), the International Social Security Association (ISSA) had conducted a study in 2002 on ten African countries, namely: Burundi, Burkina Faso, Algeria, Mozambique, Niger, Cameroon, Tunisia, Senegal, Cote D’Ivoire, and Morocco. The result will be presented below.

Legal framework for investments

1. The majority of the social security systems in Africa are based on laws, decrees and/or regulations, orders or circulars.
2. The issue of investments is dealt with in different ways based on the legal provisions governing the investments. Most of the legal provisions are not particularly precise and do not offer guidelines for investment questions.

3. According to the information provided, at the present time, the relationship between the national development plan and the social security organizations’ investment plan is merely incidental. This is because a social security organization can not replace good macro economic regional, educational or housing policies, which are the government’s responsibility.

**General Investment Principles**

All the organizations that replied to the survey stress the following three principles:

- Security, to protect the contributors’ money.
- Maximum returns on the funds invested.
- Liquidity, to ensure the availability of sufficient funds, when required.

Six countries (Cameroon, Niger, Tunisia, Burkina Faso, Algeria, Mozambique) apply a fourth principles the economic and social utility of investments.

Seven of ten countries do not mention precise goals for investment returns.

Four countries (Tunisia, Senegal, Cameroon, and Mozambique) consider that diversification is a very important aspect of investment.

**Investment Policy and Management**

A number of schemes indicate that they do not have a specific investment policy.

In general, these social security funds only discuss investment policy at the Board of Directors budget meetings. The following exceptions were noted: Tunisia has a commission on investments presided by the minister of social affairs; the investment
committee of Mozambique is chaired by the chairman of the Board of Directors; and in Senegal the office of the Board of Directors defines the organization’s investment policy. In the case of Morocco, the investment committee is not made up of administrators or government representatives, but is presided over by the Director General and his financial staff.

**Types of Investment handled**

The various types of investment may be summarized in five categories:

Category 1: Investment in the money market

- short-term deposits in banks,
- deposit in the public treasury,
- investment in commercial paper,
- investment in savings accounts and
- investment in certificate of deposit.

Category 2: Government securities

- assailable treasury bills
- short-term treasury bills
- stock market tradable treasury bills
- (capital) bonds

Category 3: Business loans

- Bonds
- Privately guaranteed loans
Category 4: Shares of enterprises, and collective investments in negotiable securities

- shares of public or private enterprises, listed or not listed on the stock exchange

Category 5: Real estate and investment in social areas

- apartment blocks
- social housing
- training in the health care field and constructing socio medical centers
- Nursery and primary schools.

Only Morocco, Tunisia, Senegal and Côte d’Ivoire invest in the stock market, in bonds, the money market, or in shares, but to a limited extent.

The following countries apply a strong social investment policy:

- Cameroon is developing a vigorous programme of action for nursery and primary schools, on the one hand, and hospitals and housing, on the other.
- Tunisia and Morocco have a very innovative housing or housing loan policies, aimed at providing housing for employees
- Tunisia is the only country to offer automobile, personal and university student loans to its members.

The trend seems to be towards a reduction of social investments in the majority of African funds, due to their financial difficulties, in particular the decrease in salaried employment and the increase in the informal sector, and population ageing.
Investment Performance

Countries can be divided into three categories according to the amount of their invested assets. Recent annual rate of return data are shown below:

<table>
<thead>
<tr>
<th>Country</th>
<th>Invested assets (in millions)</th>
<th>Rate of Return (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Group 1: High level of investment</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Morocco</td>
<td>1,200</td>
<td>7-8</td>
</tr>
<tr>
<td>Cameroon</td>
<td>383</td>
<td>2.68</td>
</tr>
<tr>
<td>Tunisia</td>
<td>252</td>
<td>7-8</td>
</tr>
<tr>
<td><strong>Group 2: Medium level investment</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cote d’Ivore</td>
<td>152</td>
<td>7-7.5</td>
</tr>
<tr>
<td>Senegal</td>
<td>122</td>
<td>8</td>
</tr>
<tr>
<td><strong>Group 3: Low level of investment</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Niger</td>
<td></td>
<td>1.8</td>
</tr>
<tr>
<td>Burkina Faso</td>
<td></td>
<td>7</td>
</tr>
<tr>
<td>Burundi</td>
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(Source: Social security documentation, African series, No 24)

In 1997 the International Social Security Association (ISSA) conducted research on various English-speaking African social security institutions (Zimbabwe, Zambia, Uganda, Nigeria, Mauritius and Ethiopia). The following were written by Dann Kunga Musege (1997) as challenges for investment management in these countries:
• In adequate legislation on investment activities which in some cases leads to 
unwarranted exposure or lack of protection for the investing social security 
institutions.

• Government intervention in dictating investment areas especially into property or 
in some cases rendering fiscal support to the government institutions. This is more 
prevalent in institutions where the Board is not independent and comprises mainly 
of government or government appointed representatives.

• High bank failure rates.

• Undeveloped capital markets and in particular stock exchanges leading to lack of 
liquidity making it difficult to dispose of acquired stock.

• Lack of diversity in financial investments makes it difficult to implement 
desirable asset allocations in line with actuarial projections and the matching of 
assets and liabilities in the context of local volatility becomes onerous.

• Lack of fund management skills coupled with a lack of understanding on the 
operations of a number of instruments by the market players and policy makers at 
large thus making it difficult to sell the merits or de-merits of particular 
investments.

• There is a general failure or reluctance to out-source the investment management 
function to suitably qualified professionals.

• Lack of rating companies for cooperate bonds and debt instruments . 
(Source: Social security documentation, Africa series, No 24)

( Source: Social security documentation, Africa series, No 24)
2. India

India’s New Pension system (NPS)

- Direct contribution scheme, market determined rates of return.
- Individual accounts,
- Central record-keeping agency (CRA)
- Competing fund managers
- Independent pension fund regulator
- A two-tier system

Tier 1: Currently available only to central government employees, mandatory 20% contribution.

Tier 2: available to any one, voluntary, no tax benefits.

Pension fund Management

The fund management in the new pension system of India requires:

- The number of fund managers is limited to ten
- The fund managers will be selected through an auction where primary selection criteria is the lowest cost of fund management offered
- The schemes that the fund managers can offer are limited to three basic combinations of bond and equity exposure:

  1. **Safe**: 70% of the funds in government of India bond portfolio, the rest in equity.
  2. **Medium**: 50% of the funds in government of India bonds.
  3. **Risky**: 40% of the funds in government of India bonds.
Regulation for Fund Management in India

There is an independent pensions regulator, pension Fund regulatory and /development Authority. Pension fund management regulation will draw principles and lessons from mutual fund regulation. A key aspect is self-monitoring by an individual of their own cumulated funds.

An over arching concerning ensuring the safety the funds collected and invested from deliberate fraud and malpractice. This is especially important in emerging market countries where governance is a big concern. Because pension funds are invested over long time spans of over 30-35 years.

**Investible Universe of Assets for Pension Funds in India**

The long-term horizon nature of pension funds implies that these funds can benefit most from returns out of diversified investments. World-wide, most pension funds have a home country bias. Pension funds have also been the primary drivers for international investments.

In India the investible assets are:

- Equity, spot and derivatives.
- Debt, mainly control government bonds
- Commodity derivatives, including both agricultural and non-agricultural commodities.

The stock of government of India to day is approximately USD 11 trillion. The market cap of the set of tradable stocks is USD 550 billion. There is no good measure of the size of pension fund stock in India. However, estimates place it between USD 40-60 billion (Susan Thomas www. IGIDR. Ac. In).
3. USA

Latest data shows that U.S. institutional investors controlled $19,634 trillion in assets in 2003, “This means that, despite a brief Liatos, the economic power and Clout of U.S. institutional investors continuous” (Carolyn Kay Brancato Director of Global corporate Governance Research Center, 2005). Looking at the mix of institutional investors, pension funds owned 40.7% of total U.S. equity assets in 2003, investment companies 22%, insurance companies 23.3%, bank and trust companies 11.7%, and foundations 2.4%.

Activist Pension funds Growing in Ownership and Clout

Within the pension fund category, the more “activist” public employee pension funds have growth from 7.4% of total institutional investors’ assets in 1980 to 11.6% in 2003. Considering pension funds assets alone, these public funds controlled $196.6 billion in assets in 1980 (22.6% of total pension fund assets of $871 billion). By 2003, they held $2.27 trillion in assets (28.4% of all pension fund assets). “This continued growth is significant because, among the categories of institutional investors, the public pension funds are the most activist and the most coordinated with other global institutional investors.” (Brancato, 2005).

Total institutional investors have also gained even greater control of U.S. equity markets. In 2003, these institutions controlled $7,974 trillion in equities or 59.2% of outstanding equities in the U.S. up from $6.6 trillion or 51.8% of equities in 2000. The activist U.S. pension funds continue to a mass relatively more control over companies as their percentage of total equities rose from 7.6% in 2000 to 9.7 in 2003.
The 25 pension funds that are the largest investor abroad continue to expand their investments outside the U.S. “since more than three quarters of these largest investors are public pension funds and likely to be more activist in corporate governance, they are increasingly likely to have a greater impact on the corporate governance practices of foreign corporations (Brancato, 2005).

2.7. Current Issues in Social Security Investment

1. Market Development

In an economy where market regulation mechanisms are introduced and practiced, the social security institutions can stimulate the development of domestic capital markets. In the absence of enforceable market regulations (including bank supervision, disclosure requirements and securities legislation), capital markets will be responsible for the failure of social security investment.

2. Diversification

Diversification of investments in different portfolios reduces investment risks. But diversification has got a problem in developing countries as these countries have undeveloped capital markets with out a developed capital market, social security institutions will face liquidity problem.

Investing abroad (foreign investment) may be taken as a solution to alleviate the diversification constraint of the domestic market with undeveloped capital markets.

3. Legislation (Independence)

According to a study by the international Labor organization (ILO, 1997), Legislation governing social security institutions’ investments can be broadly categorized as follows, in all cases with or without a requirement for ministerial approval:
a) Responsibility for investments is delegated to the institution.

b) Investment is subject to specified minimum or maximums, in various mediums.

c) Investments may be made in accordance with trustee acts.

4. Management

a) Disclosure/public information

In most developed countries, contributors of the pension fund are aware of about the regular reports (like income statement, Balance sheet, etc). As written by ILO (1997), contributors should also be aware of about investment policy and strategy of the board, and the performance of the scheme should be explained and analyzed.

b) Privatization

Many researchers have presented a proposal on privatizing publicly managed social security funds to avoid theory deficiencies in different aspects. It is clear and obvious that privately managed organizations are by far efficient and effective in all cases when compared with publicly managed organizations.

Privatization of publicly held social security funds requires a sufficiently developed domestic capital market, and possible diversification of investments to external markets (ILO, 1977).

5. Pension fund investment in hedge funds

Hedging of pension fund investments is among the recent innovations of pension fund management. The concept and idea is new for most of the pension fund regulators and as such do not have strong policy, strategy and guideline for this investment. Its importance comes from the risk off setting nature of the investments. Hence, Hedging reduces risk through diversification as the investments are less correlated.
According to Stewart, F. (2007), a survey has made with the following countries: Australia, Austria, Belgium, Canada, Colombia, Czech Republic, Denmark, Estonia Finland, Germany, Greece, Ireland, Israel, Italy, Luxembourg, Mexico, Netherlands, Poland, Portugal, Slovakia, Spain, Switzerland, Turkey, and Uk. The survey attempts to establish whether pension regulators had more specific information on the extent to which pensions in their jurisdiction were investing in Hedge funds, the type of pension funds which are exposed, and what type of hedge fund they are investing in.

The results are summarized as follows:

1. Pension fund regulators have limited information regarding how pension funds in their jurisdiction are investing in hedge funds.

2. Most regulators do have a range of methods through which to control pension funds’ investments in hedge funds-ranging from strict quantitative limits to the prudent person rule.

3. Regulators remained concerned that as pension funds exposure to hedge funds raises further policy responses will be required.

4. Accurate figures for the level of investment are only available in Finland, at 3.1%.

5. Only the Czech Republic was able to supply information on what type of hedge fund strategies pension funds are particularly attracted.

6. Pension funds as financial intermediaries

Just like the banks and capital markets, pension funds can play a role as financial intermediaries in the financial system. The role of pension funds in this category comes from the following activities collecting savings, investing in securities and other financial
assets, disbursing annuities, proving forms of insurance, acting as operators in securities markets, cross border investors and owners of companies.

Davis (2000) wrote as pension funds have been able to fulfill a number of functions to the financial system, either directly or indirectly, more efficiently than other types of institution or than direct holding. In this sense, pension funds may be seen as more efficient financial institutions that are tending to displace existing arrangements. They tend to complement capital markets and act as substitutes for banks.

It has been emphasized that growth of pension funds is also a consequence of fiscal incentives.

7. Pension funds practice in socially responsible investments

Ethical investment or socially responsible investment involves the investment of excess cash balances from households, corporate, organizational, or personal funds in alignment with the investor’s value. These values may be of a religious, social, economical, environmental, cultural, and other nature (Sturm and Badde, 2001).

For example,

1. In UK 59% of the 500 pension funds incorporating socially responsible investment process, either through the fund manager or through engagement, or both.

2. USA pension funds control financial assets of more than 6.7 trillion USD, total investment assets amount 16.3 trillion USD, socially responsible investing of major investing institutions (pension funds, mutual funds, foundations, religious organizations) totals 2.1 trillion USD, or roughly 13% of the total invested assets (Sturm and Badde, 2001).
These socially responsible investments of pension funds are also a new phenomenon. The pension funds of many developed countries (Like USA, Canada, Uk, etc) included in their investment policy and strategy, certain African countries are also participating in such activities like nursery and primary school, (Cameroon), housing loan policies (Tunisia and Morocco), and the like. Many of African countries have also included the social utility as their principle of pension fund investment.
CHAPTER THREE

Back Ground of The organization

3.1 Short History of the Ethiopian Social Security Agency (ESSA)

Ethiopian social security system has developed gradually in response to a variety of social, economic and political factors. After the Battle of Adowa in 1996, Emperor Minillik the second allotted land for war veterans including the survivors of those who lost their lives in the war. Although this laudable piece of act can be considered as to have marked the beginning of a sort of social security service in Ethiopia, it was not without flaws of its own. There was no law to ensure its enforcement, it lacked uniformity in application and, surely, not every one involved benefited equally as the room for favoritism was wide open as it was not be claimed as legal right.

In the 1930s with the appearance of modern institutions and the development in beaurocratic machinery as well as the growth in the number of paid officials in all spheres of government operations, the need for a pension law was being discussed in the parliament. By then, Ethiopia was invaded by fascist Italy and all national efforts of economic and social development came to end. Right after the end of the war, the government tried to compensate the injured and the families who lost their breadwinner by giving out land and money payable annually.
This development led the coming into force of Public Servants’ Pension Decree No.46/1961 (amended by proclamation No. 209/1963), which laid the foundation for the first establishment of the Ethiopian Pension Scheme. Initially, this scheme covered the government civil servants and the military. Later, as a result of the Ethiopian Revolution, all workers employed in the government undertakings, which were previously in private holdings, were included in the scheme. The extension of the scheme, along with other expansion of the public service sector, resulted in the growth of the scheme.

3.1.1 The Ethiopian Pension Law

The Ethiopian Pension Scheme is contributory, earnings and services related, social insurance program whose objective is to give protection against loss of income to a member of the scheme and their survivors. The contingencies covered in the scheme are: old age, invalidity, employment injury and death (survivor’s) benefits.

The pension legislation which governs the scheme has been amended on several occasions. These are proclamation No.49/1975, which extends the Public Servants’ Pension Proclamation (earlier confined to civil and military government employees) to give protection and coverage to permanent employees of government owned under takings and their families and the determination of minimum pension benefits; Proclamation No. 38/1996 Which establishes the Social Security Commission as a Federal Authority and called the Ethiopian Social Security Authority, and it becomes an autonomous federal office, having its own juridical personality accountable to the Council of Ministers; Proclamation No.345/2003 given as it is found necessary to strengthen, to the extent circumstances allow, the public servants’ pension scheme.
organized under existing laws, and to amend and consolidate the pension legislation and called the Public Servant “ any person permanently employed in any public office (this includes a government appointee, member of the Defense Force and the police); Proclamation No.495/2006 issued to re-establish the Social Security Authority as an autonomous federal agency having its own juridical personality and change its accountable to the Prime Minister; and the Little amendment has made by October 24,2003 (Procl.No.424/2004) about the age limitations of the pensioners.

Scope of the Coverage

The scope covers two groups of employees, who have Ethiopian Nationality by birth or acquisition and these are:

A). the civilian government employees comprising

✓ Government officials and agents, who are to any degree repositories of the power or authority of the state, and whose salaries are paid by the Minister of Finance out of the National Budget;

✓ Employees of all autonomous organizations and public agencies of any kind

B). the Military

✓ All persons undertaking military service who are entitled to wear military uniform, and members of the Polices Forces, for the purpose of pension coverage, are regarded as members of the Armed Forces.

3.1.2 Contributions

The amount of contribution for a scheme is to be assessed actuarially and is to be determined based on a system of financing of the scheme. The rate of contribution has
not been changed since the establishment of the scheme and the amount of contribution is 10% of the basic salary for the civilian while it is 20% of their basic salary for the military. The Public servants’ share of contribution is 4% of the basic salary and the remaining, 6% of their basic salary for the civilian and 16% of their basic salary for military, is contributed by their employer.

3.1.3 Administration of the Pension Scheme

The administration of the Ethiopian Pension Scheme, since its establishment in 1961, has undergone several organizational and procedural changes from which evolved the current system. The system involves the process of managing the day-to-day progress and assuring the long term viability of the scheme. The Ethiopian Social Security Agency (previously called the Pension and Social Security Commission of Ethiopia) is headed by a governmental appointed Board of Director followed by the Director General (member and secretary of the Board) and the Deputy Director General. Under the Deputy Director General are departments and services which are either operational or support giving units. This structure does not consider the newly and not functional structure of the agency developed by the Business Process Re-engineering group.

3.1.4 Financial administration

The financial administration of the pension fund involves the collection of pension contribution, payment of benefits to the beneficiaries and the investment of the reserve money. The agency has given the full power and duty to invest the social security fund in any investment activity.
CHAPTER FOUR
ANALYSIS AND PRESENTATION

4.1 OBJECTIVE, POWER AND DUTY THE AGENCY

Until June, 2006 its name was called as “Ethiopia Social Security Authority”. But, by June 29th, 2006, Proclamation no.495/2006, has issued to re-establish it as an autonomous federal agency having its own juridical personality and named as “Ethiopian Social Security Agency”. The agency shall be accountable to the Prime Minister.

4.1.1 Objective

The objective of the Agency shall be to strengthen and expand social security programs.

4.1.2 Powers and Duties

The Agency shall have the powers and duties to:

- implement social security laws, regulations and directives;
- establish a system for the collection of social security contributions and collect the social security contributions; ensure that every employer implements the system;
- inspect related records and documents where necessary by requiring their submission to it or by visiting the premises of employers;
- administer social security funds;
- collect in advance and maintain records of evidentiary data that entitle persons to social security benefits;
➤ take legal actions against employers and individuals who fail to pay social
security contributions, establish contributions record system and to furnish
required documents or information on time;
➤ determine the adequacy of entitlement claims evidentiary documents, the types
and amount of social security benefits to which a beneficiary is entitled, effect payment of benefits;
➤ decide on claims related to social security rights and benefits;
➤ invest the social security funds in profitable and reliable investment activities;
➤ cause periodical actuarial study and review of the social security funds;
➤ undertake studies to strengthen and expand social security programs and
coverage, submit it to the government and implement same upon approval;
➤ issue directives on matters that come within its powers and duties;
➤ own property, enter into contracts, sue and be sued in its own name;
➤ carry out such other activities as may be necessary for the fulfillment of its
objective

4.1.3 Organization of the Agency

The Agency has:

❖ A Board of Management
❖ Director General and, as may be required, Deputy Director-Generals to be
appointed by the Government; and
❖ The necessary staff.
❖ Members of the board, including the Chairperson, shall be appointed by the
Government with their number to be determined as necessary.
The Director General of the Agency shall be member and secretary of the Board.

(Source: Federal Negarit Gazeta Procl. No.495/2006)

4.2 DATA ANALYSIS AND PRESENTATION

4.2.1 QUESTIONNAIRE ANALYSIS

Introduction

In order to undertake this study, 45 questionnaires were distributed to different respondents, of which 39 has collected. The respondents were from research staffs of banks, academicians, chamber of commerce employees, Ethiopian development research institute, and Ethiopian social security agency.

The questionnaire had of four parts. Part I is about the respondents profile, part II consists of questions related to the past practices of pension fund investment, in part III questions regarding present investment activities are asked, and in part IV questions that seek information about the future investment opportunities and challenges are presented. Part II and part III of the questions are filled by present and former employees of ESSA. The last part (part IV) is filled by all of the respondents as it requires general opinion about future opportunities and challenges of pension fund investment in Ethiopia.

4.2.2 Respondents profile

From the 39 respondents, 4(10.26%) are female and the rest, 35(89.74%) of them are male. Of them, 21(53.85%) are MSC (MA) holders with Accounting and finance, economics, and regional and local development studies. The rest are BA holders with Accounting, Accounting and finance, management and economics. The respondents were selected based on judgmental /purposive/ sampling techniques as respondents with
better information are expected for giving relevant information for better analysis and suggestion.

4.2.3 The past practices of pension fund investment

In this section four questions were presented to the present and former staffs of the ESSA. The questions were seeking information regarding how the pension fund was administered in the past, the investment practices, whether there was adequate investment opportunities and to list those investment opportunities available in the past.

Five respondents were filled the questions regarding the past practices of pension fund administration. According to the respondents, previously pension fund was administered by a department under the social security authority. It was administered as a pay – as go basis, where pension payments are made out of the general revenue. The fund includes the military and civilian funds. There were three fund administrators guided by the board. Now the fund administrators are two in numbers. Until 1990 E.C the pension contribution collection and pension payments were executed by the ministry of finance and economic development (MOFED). But, since then, the pension contribution collection is under taken by ESSA and the payment to pensioners is out sourced to the commercial nominees on a fee basis. Right now an investment office is instituted to effectively and efficiently manage the investment of pension funds.

From the five respondents, two said earlier on there were investment opportunities like real estate mortgage and commercial banks. Those respondents who are employees of ESSA right now said nothing about the opportunities that were available in the past. But the other respondents (two of the five), who was employees of ESSA earlier and left the company, said yes there were investment opportunities.
4.2.4 Present investment practices of pension fund

This section is the third part of the questionnaire. It encompasses questions that seek information from the respondents about the current investment practices of pension fund in Ethiopia. Accordingly, the following questions were included:

✓ Whether respondents have a close information about pension fund investment in Ethiopia,

✓ Whether there are more/less opportunities for pension fund investment in Ethiopia now than before,

✓ How the respondents grade the attractiveness (profitability) of the market of the current pension fund investment in Ethiopia and with the following three choices included: very attractive, fairly attractive and not that attractive,

✓ How the respondents evaluate the cost of pension fund investment in Ethiopia with three alternatives included: sufficient, not bad, and not sufficient,

✓ The types of assets under taken by the ESSA for pension fund investment,

✓ Whether the types of assets currently available for pension fund investment are sufficient and with three alternatives provided: sufficient, moderately sufficient, and not sufficient and,

✓ Their opinion about the challenges faced by ESSA regarding pension fund investment currently.

Given the above questions presented to five present and former staffs of ESSA, their response is summarized as follows:

Respondents who have a close information about present investment practices of the pension fund said that there are more investment opportunities now than before.
Currently pension fund investment is fairly attractive in terms of profitability. The cost of pension fund investment is cheap as the respondents replied.

Pension fund investment has undertaken on the following assets: treasury bills, fixed time deposit, government bonds, corporate bonds and shares, demand deposit, real estate (under taken now) and saving account (approved but not yet get implemented). These assets are moderately sufficient for pension fund investment as they replied.

*The Challenges faced by ESSA regarding current pension fund investment are:*

- The agency earns low return on investment usually below inflation rate,
- Limited expertise in the field or absence of qualified professionals in the area of pension fund management, and
- Absence of financial markets

### 4.2.5 Future investment opportunities and challenges

As it has tried to indicate in the introduction part of this chapter, this part (part IV) of the questionnaire contains questions that seek information from the respondents about the future investment opportunities and challenges of pension fund investment in Ethiopia. All of the respondents have given the chance to give their opinions and suggestions. The questions are summarized into eight major ones and the responses are summarized and presented in the following sections.

The first questions forwarded to the respondents were about whether there will be more opportunities for the pension fund investment in Ethiopia; and to reason out their responses accordingly.
Table I: Information about future opportunities

<table>
<thead>
<tr>
<th>Do you think that there will be more opportunity for the pension fund investment in Ethiopia in the future?</th>
<th>Yes</th>
<th>No</th>
<th>Totals</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>37</td>
<td>2</td>
<td>39</td>
</tr>
<tr>
<td>Percent</td>
<td>94.87</td>
<td>5.13</td>
<td>100</td>
</tr>
</tbody>
</table>

(Source: own survey, April 2009)

As shown in the above table 94.87% (37) of the respondents said there are investment opportunities in Ethiopia to invest the pension fund. The rest, 5.13% (2) of the respondents, said there is no opportunity for pension fund investment in the future.

The respondents who said there will be opportunities for pension fund investment in the future justified the following reasons:

- More foreign investors are coming to our country than before,
- Our country is more or less showing stable economic growth,
- The hope that stock exchange market will be established in the future,
- The ESSA has given the mandate to invest the fund in profitable and reliable investment areas than before,
- The development of the private sector and expansion of share companies including private banks and insurances,
- The government’s better and liberal investment policy,
- Special consideration of insurance and banks towards pension fund for long term loan and as a share holder,
- There is a tendency to have large and capital intensive organizations. This gives an opportunity to buy their shares and bonds and enjoy a better return,
- There will be better legal framework and other similar changes due to national and international pressures (Globalization),
- Since a lot of huge projects are undertaken and these projects need bank loans, local banks may access the pension fund by giving better interest (return),
- Finance professionals are coming to the market and proper fund management will be there (of course, experience may be a problem for some days).

Those respondents who replied as there will not be investment opportunities in the future said that the government may narrow the room (opportunities) as the government is the only autonomous decision maker regarding pension fund management.

The second question asks the respondents to give their opinion on whether the ESSA will face challenges in the future related to investment practices, and to forward their suggestions as a general solution and solutions expected from the government.

**Table 2: information about future challenges to be faced by ESSA**

<table>
<thead>
<tr>
<th>Do you think that the Ethiopian social security agency will face a challenge in the future related to investment practices?</th>
<th>Yes</th>
<th>No</th>
<th>No Idea</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>34</td>
<td>3</td>
<td>2</td>
<td>39</td>
</tr>
<tr>
<td>Percent</td>
<td>87.18</td>
<td>7.69</td>
<td>5.13</td>
<td>100</td>
</tr>
</tbody>
</table>

(Source: own survey, April 2009)

As shown in the above table or table 2, 87.18% of the respondents said that the ESSA will face a challenge related to its investment in the future, 7.69% of the respondents replied as there will not be a challenge to be faced by the ESSA regarding its future investment practices and the rest, 5.13% of the respondents give no idea about.
Those respondents who replied as the pension fund will face a challenge regarding future investment practices mentioned the following points as future challenges:

- High government intervention in the management of pension funds,
- Lack of clear investment guidelines, policy, strategy, mission and objective,
- Lack of due attention to the pension fund investment from the responsible bodies,
- Problem of accessing capable professionals to assess and evaluate the available opportunities,
- Lack of professional fund managers who has specialized in the area,
- Problem of legal framework that governs the administration of pension fund. Because right now it seems that the government is using the fund to finance its budget deficit. So, unless the legal framework is changed, the ESSA will suffer a lot to use the money for other productive purposes,
- Problem of under talking feasibility studies to carefully select sustainable projects,
- Managing the military and the civilian funds together because the number of pensioners from the military side are unknown due to security and other reasons,
- Pension funds are not expected to incur a loss in its investment,
- In availability of stock exchange markets, and related regulatory frameworks,
- Challenges from competitors in similar investment areas,
- Privately managed pension funds will come in the country and pose a big challenge on the publicly managed pension fund, and
- Problem of accountability and responsibility to manage the fund.
In addition, these respondents suggest the following as solutions to alleviate the above challenges:

- the government should facilitate the formation of the stock exchange market,
- ESSA should be independent manager of the fund. That is, government should stop its intervention.
- Government should improve the legal infrastructure for other institutions (specially foreign companies) to come and invest in Ethiopia,
- Adequate man power should be trained,
- The law that governs the administration of pension fund should be rewritten more clearly and precisely,
- The agency must be staffed with reasoned individuals,
- Government should administer the military pension fund and the civilian pension fund separately,
- Government should create public awareness about the management of pension fund,
- ESSA need to develop or set strategies and policy that guides its activities and evaluates its operations,
- Needs capacity building of ESSA employees regarding portfolio management, liquidity management and other related areas,
- Privatizing the pension fund may be one solution,
- Draw on experience of other countries pension fund investment, and
- Taking initiatives to manage provident funds of private companies to increase its financial capacity.
The third question was about whether pension fund investment can be feasible in the absence of stock exchange market, the types of assets available for pension fund investment in the absence of stock exchange market, and the benefits to be bring about for pension fund investment if stock exchange market is established in Ethiopia.

**Table 3: information on pension fund investment in the absence of stock exchange market**

<table>
<thead>
<tr>
<th>Do you think investment of pension funds is going to be feasible in the absence of stock exchange market?</th>
<th>Yes</th>
<th>No</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>28</td>
<td>11</td>
<td>39</td>
</tr>
<tr>
<td>Percent</td>
<td>71.18</td>
<td>28.82</td>
<td>100</td>
</tr>
</tbody>
</table>

(Source: own survey, April 2009)

As it is shown in the table above, 71.18% of the respondents said that it is possible to have a feasible pension fund investment in the absence of organized stock exchange market. As the respondents replied, the following assets is going to be feasible investment opportunities even with the absence of stock exchange market: real estates, bonds and shares of government corporations, shares of companies under formation, banks and insurances, engaging in construction business, participating in agriculture industry, giving services just like small financial institutions and even establishing its own bank to give financial services. As some of these respondents said, there are investments opportunities that can not await the formation of stock exchange market in Ethiopia.

28.82% of the respondents said pension fund investment can not go ahead unless there is an organized stock exchange market. They said, if there is no stock exchange market, the
number of alternative assets available for investment will be too limited; liquidity of shares and bonds of private companies will be in question which implies investment in such areas will be too risky for pension fund to invest.

Even though the respondents have given different responses regarding pension fund investment feasibility in the absence of stock exchange market, all of them agreed on the advantages brought by the formation of stock exchange market for pension fund investment. They said the establishment of organized stock exchange market in Ethiopia will increase the asset types available for investment, increases the liquidity of the already invested assets, mobilizes capital, and reduces risk.

The fourth question enquires the opinions of the respondents whether the absence of stock exchange market in Ethiopia be a challenge for pension fund investment, and any country if any, they know that invest pension fund in the absence of stock exchange market.

**Table 4: Information on whether absence of stock exchange market is a challenge for pension fund investment**

<table>
<thead>
<tr>
<th>In your opinion, do you think the absence of stock exchange market in Ethiopia be a challenge for pension fund investment practices?</th>
<th>Yes</th>
<th>No</th>
<th>No opinion</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>22</td>
<td>15</td>
<td>2</td>
<td>39</td>
</tr>
<tr>
<td>Percent</td>
<td>56.51</td>
<td>38.46</td>
<td>5.13</td>
<td>100</td>
</tr>
</tbody>
</table>

(Source: own survey, April 2009)

As it is shown in table 3, fifteen respondents (38.46% of the respondent) believed the absence of stock exchange market can not be a challenge for a conductive pension fund
investment. Because, they said, still we have ample investment opportunities that need not await the formation of stock exchange market like real estate, agriculture, education, construction, Government Corporation’s like telecommunication, Ethiopian electric power corporation bonds and shares, and others.

Twenty two (56.51% of the respondents said that it is difficult to undertake a conducive investment of pension fund in the absence of stock exchange market. Because asset types will be limited, it will be too risky to liquidate the bonds and shares of private corporations where attractive net income is reported annually and the like. As a result, absence of organized stock exchange market is a challenge for proper pension fund management. The rest two respondents (5.13%) have given no opinion. No respondent has forwarded a country that invests pension fund in the absence of stock exchange market.

The fifth question was regarding the contribution of proper pension fund management to the economic development in the country, and to suggest the potential contribution to be grasped if properly managed.

As all of the respondents replied proper pension fund management will play a contributing role to economic development of the country. The following points are suggested by the respondents as the contribution of pension fund investment in the country’s economic development.

- Living standard of the retirees (Pensioners) will be improved as their income increases,
- There will be capital mobilization from one sector to another sector as investment of pension funds is expected to be in diversified sectors,
• Employment opportunity will be created as a result of increase in productivity because properly managed pension funds increase productivity,

• Poverty will be alleviated (reduced) as pensioners income will increase and due increase in productivity,

• There will be income distribution ,and

• As an active player in the financial market, pension funds could increase the liquidity of the market.

In this section (sixth question), respondents were asked whether there are professional fund managers in Ethiopia who can consult pension fund investment.

**Table 5: Information about professional fund managers**

<table>
<thead>
<tr>
<th>Do you think that there are professional fund managers in Ethiopia who can consult pension fund investment?</th>
<th>Yes</th>
<th>No</th>
<th>No opinion</th>
<th>total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>16</td>
<td>15</td>
<td>8</td>
<td>39</td>
</tr>
<tr>
<td><strong>Percent</strong></td>
<td>41.03</td>
<td>38.46</td>
<td>20.15</td>
<td>100</td>
</tr>
</tbody>
</table>

(Source: own survey, April 2009)

As depicted in table 4 above, 41.03 % of the respondents replied there are qualified fund managers who can advice pension fund investment. Especially, respondents of academicians have granted on the presence of professional fund managers.

38.46% of the respondents said there are no enough professional fund managers who can give professional advice regarding pension fund investment practices. The rest, 20.51% of the respondents gave no opinion about the presence or absence of professional fund managers who can consult pension fund investment.
The seventh question was about whether the Ethiopia fiscal policy encourages the development and economic contribution of the pension fund investment.

**Table 6: information on the Ethiopia fiscal policy regarding pension fund investment**

<table>
<thead>
<tr>
<th>Does the fiscal policy of Ethiopia encourage the development and economic contribution of pension fund investment</th>
<th>Yes</th>
<th>No</th>
<th>No opinion</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>8</td>
<td>18</td>
<td>13</td>
<td>39</td>
</tr>
<tr>
<td>percent</td>
<td>20.15</td>
<td>46.15</td>
<td>33.33</td>
<td>100</td>
</tr>
</tbody>
</table>

(Source: own survey, April 2009)

As it is clearly seen in the table above, 20.15% the respondents said the Ethiopian government fiscal policy has encouraged the investment of pension fund and considers its economic contribution. 46.15% of the respondents replied as the Ethiopian fiscal policy did not encourage the development of pension fund investment and its contribution to economic development. The rest, 33.33% have give no idea concerning the question.

The last question had given a chance to the respondents to forward their general opinion, suggestion, idea (information) they believe is important about the opportunities and challenges of pension fund investment in Ethiopia.

**General suggestions and opinions of the respondents:**

1. The Ethiopian pension fund will have a better opportunity of investment if the government opens its doors for foreign banks to come to Ethiopia.

2. Pension funds should be administered by a strong and committed board of directors. The board should include the civil servants (employees), the pension association, and the government.
3. For effective pension fund investment it needs to promote fund managers who are operating right now and others in the market.

4. The existing investment opportunities are not being exploited and seem that it is the policy not the opportunity that is bottle necks of pension fund investment development.

5. The huge money that the agency sits on can be rechannelled to many investment areas and the agency could be an active player in galvanizing the economy by significant amount of capital and left untapped by the private sector if the existing legal structure is improved.

6. As Ethiopia is working towards being a member of World Trade Organization, the development of pension fund investment will enable most poor to be out of poverty life, that is, there will be a chance to invest the fund. The challenge may be the possibility of finding good managers working in this area.

7. We are probably the only country in the world with one of the oldest pension schemes and don’t know what to do with a huge capital that has been put idle in the banks. The opportunities are there now. What is lacking is the will. Therefore, what the future will bring is the will on the part of the government.
4.3 Interview analysis

An interview was held with the Ethiopian Social Security Agency investment office manager Ato Fasil. Seven questions were presented to him and the response is presented as follows:

✓ First, a question regarding the objective of investing the pension fund was presented. He said, the objective of investing the pension fund is to improve the social and economic life the pensioners (retirees) using the return (yield) from the investment and to keep the sustainability of the fund. To do this, the pension fund is not going to be invested in any opportunity (asset) that has seen profitable. This fund is the money of others and it is a liability for the agency. Therefore, since the agency is expected to pay in the future the pension fund should be invested in the safest areas. Safe investment areas have low returns. As a result, the agency is receiving low return in response of wishing safe and risk free areas (assets).

✓ Second, the capacity of the agency to handle the pension fund as per its choice of investment was asked by the interviewer and he replied as, in theory and in the proclamation too, the ESSA has the full capacity to handle the pension fund per its choice of investment. Of course, the agency is now under taking so many projects by its own discretion like real estate and others. But some times by considering the economic environment or condition, the government may interfere as seen it necessary. For example, during 2000E.C different governmental companies like commercial bank of Ethiopia, Ethiopia electric power corporation, and other governmental organizations have presented a
proposal to sale their shares and bonds to ESSA. At this time the government has blocked their question. It has blocked due to its inflationary effect, government believes the money will aggravate the inflation.

The third and fourth questions were about whether the agency has clear investment guide lines, policy, strategy, mission, and objective; and how they evaluate the pension fund administration with the specified guide lines, policy, strategy, mission, and objective. The response of the interviewee was, the ESSA have no clear investment guide lines, polices, mission and strategy still then. Investment is based on the three principles: safety, liquidity and return. The Agency is now developing investment policy, guide line, and strategy. At the end of 2001 budget year and there after guidelines, policies, strategy, mission and clear objectives will be under operation. As there is no clear guideline, policy, strategy and mission statement it is difficult to evaluate the pension fund administration on the above bench marks.

The fifth question seeks information on how the ESSA communicates its performance to ESSA, and the bench mark, if any, for evaluating their performance. He said, the performance of the agency is communicated through annual reports presented to the Parliament. The bench mark for evaluating their performance is the budget approved by the Parliament at the beginning of the year.

The sixth interview question was about the challenges the ESSA faced pension fund investment. The ESSA have got challenges regarding pension fund investment. Among these are the low return earned by investing huge amount of
money on treasury bills. The other challenge is as said above, government may intervene on decisions when it believes necessary. In addition, absence of organized group or market that helps to liquidate shares and bonds of private companies pose a problem in acquiring private shares and bonds. Lastly, the ESSA have recruited only one employee as the manager of investment office head and other employee in the ESSA staff is responsible to under take all the operations regarding pension fund investment. That is there is shortage of fund managers of professionals who is responsible to manage the pension fund.

✓ The last question is if there is additional idea to give (additional and general suggestion). As a general suggestion, he said, nothing has done regarding pension fund investment when we compared with the available opportunities. Even I can say there is no challenge as we did less till then. We may face the challenges when we do more. The opportunities will be made open and clear when young scholars made research and give us their valuable suggestions. There fore, younger scholars are welcomed to do research in this area because the area needs extensive research. (Source: own survey, April 2009)
4.4 Secondary document analysis

4.4.1 Lessons learnt from some African countries regarding pension fund administration

4.4.1.1 French speaking African countries experience of pension fund administration

According to a report by Ahmadou Yeri Diop (2002), The following African countries: Burundi, Burkina Faso, Algeria, Mozambique, Niger, Cameroon, Tunisia, Senegal, Cote D’Ivoire and Morocco are investing their pension fund on the basis of the general investment principles security (safety) of the fund, liquidity to ensure the availability of sufficient funds when required and yield (return) from the invested fund. Of the ten countries, Burkina Faso, Algeria and Mozambique include a fourth principle – the economic and social utility of investing the pension funds.

Most of the schemes do not have specific investment policy but discuss only at the board of director budget meetings. According to the study, the pension’s scheme of Morocco, Cameroon and Tunisia have showed a high level of performance; Cote d’Ivoire and Senegal reported medium level of performance; and Niger, Burkina Faso and Burundi showed low level of performance.

The pension scheme of the above countries have made investment in the following asset types: investment on business loans, investment on shares of public as well as private enterprises, investment on shares of public as well as private enterprises, and
investment on real estate and social areas like nursery and primary schools, and constructing socio medical centers (Hospitals).

The following countries apply a strong social security policy:

- Cameron is developing a vigorous program of action for nursery and primary schools on the one hand and hospitals and housings on the other hand.

- Tunisia and Morocco have a very innovative housing and housing loan policies, aiming at providing for employees. In addition, it has offered transportation, personal and university student loans to its members.

(source: Ahmadou Yeri Diop-200: social security documentation, Africa series, No 24)

4.4.1.2 The English speaking African countries Experience

According to a report by Dann Kunda Musenge (1997), the pension fund administration of seven English speaking African countries (Zimbabwe, Zambia, Uganda, Nigeria, Mauritius, Kenya and Ethiopia) have got the following challenges:

- in adequate legislation on investment activities,

- Government intervention in dictating investment areas, the board is not independent and comprises mainly of government or government appointed representatives,

- High bank failure rates,

- under developed capital markets and in particular stock exchanges leading to lack of liquidity making it difficult to dispose acquired stocks,
- Lack of diversity in financial investments, makes it difficult to implement desirable asset allocation.
- Lack of fund management skills coupled with lack of understanding on the operations of a number of instruments by the market players and policy makers at large, thus making it difficult to sell the merits or de-merits of a particular investment,
- There is a general failure or reluctance to out source the investment management function to suitably qualified professionals, and
- Lack of rating companies for corporate bonds and debt instruments

4.4.2 Comparison with the Ethiopian Pension Fund Investment management

4.4.2.1 With the French speaking African countries

As written above, the French speaking African countries made their pension fund investment on the basis of a safety, liquidity, yield and economic and social utility. In Ethiopia, the main investment principle for investing the pension fund is safety of the fund event though liquidity and return principles are also considered.

Most of the schemes including Ethiopia’s have no specific investment policy. Except the Ethiopia’s, the other countries discuss about investment policy at the board of directors budget meetings. In Ethiopia the investments depends on the opportunities available and not depend on any investment policy either written or discussed at the board level.

Tunisia has a commission on investment presided by the minister of social affairs, Mozambique has an investment committee chaired by the chair man of Board of
Directors, in Senegal the office of the Board of Directors defines the organization’s investment policy, and in Morocco the investment committee is made up of administrators or government representatives, but is presided over by the Director General. In the case of Ethiopia, there are two individuals who are responsible to manage the pension fund, including the investment office manager.

The French speaking African countries made investment in the following areas: investment on business loans, shares of public and private organizations, investment on real estate, and social areas like nursery and primary schools and constructing socio-medical centers. In our country, Ethiopia, investment is made on treasury bills, fixed time deposit, government bonds, corporate bonds and shares, demand deposit, real estate (under taken now), and saving account (approved but not yet under taken).

4.4.2.2 with the English speaking African countries

- Zambia, Kenya and Uganda have specific legal provisions regarding pension fund administration, the four countries; Mauritius Nigeria, Zimbabwe and Ethiopia have no specific legal provisions.
- Zimbabwe’s and Kenya’s pension fund investment plan have link with the national development plan. The pension fund investment plan of Zambia, Uganda, Mauritius, Nigeria and Ethiopia has no link with the national development plan.
- Of the seven English speaking African countries under survey, only Ethiopia’s pension investment have no rules and regulations for evaluation of investment operations and performance as all funds are in risk free government securities.
- In Ethiopia, there are no investment criteria, appropriate degree of diversification is not taken into consideration, investment policy depends on opportunities and
there is no specific guidelines and rules. But the other six countries have
investment criteria, considers diversification and sets investment policy at Board
level and previous market trends (Uganda only)
The following poses a problem for the Ethiopian social security investment: unstable
economic environment, under developed capital market and in adequate legislation.
(Source: Dann Kunga 1997, social security documentation Africa series No 24).

4.4.3. Some Lessons Learnt From the Inland Literatures
Ato Mesfin Abebe (2003,a master thesis submitted for RLDS,AAU) said, “I have
interviewed the higher officials of the agency , including those who have positions at
the Minister level regarding how the Pension payment subsidies the life of the
pensioners” and he summarized their response as follows. “Pension payments in
Ethiopia are not sufficient to live the minimum life. Due to this a very large number
of pensioners (approximately 90%) in Addis Ababa subsidies their living expenses by
begging people around the streets and doors. They depend on begging rather than
their pension payments.” In addition, he said, the pension payments made to most of
the pensioners elongate their harsh living conditions to improve their lives.
A review of the BPR document prepared by the agency clearly evidences the failure
of ESSA in achieving its objectives, earlier on. Because the pension paid to
pensioners in Ethiopia constitutes the lowest margin in the sub-Saharan African
countries. Besides, the pensioners have received a constant amount that did not
adjusted for inflation. (BPR, 2008/09)
The above two documents indicate that the pensioners had never ever benefited from the of pension fund investment. This evidences the failure of ESSA’s objective of “strengthening and expanding social security programs” in general and the objective of investing pension funds “improve the Social and economic life of the pensioners” in particular. An informal discussion with the investment office manager tells the researcher as this is due to excessive government intervention on the management of pension funds.
CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 SUMMARY AND CONCLUSION OF THE MAJOR FINDINGS

The following are the summaries and conclusions of the major findings.

1. Ethiopian Social Security Agency is re instituted as an autonomous federal agency on June 29th, 2006, proc.No.495/2006. It is accountable to the Prime Minister. The objective of the agency is to strengthen and expand social security programs. It has given the power and duty to invest the social security funds in profitable and reliable investment activities.

2. The objective of investing the pension fund is to improve the social and economic life of the pensioners and to assure the sustainability of the fund. Of course, it has no clear investment policy, guide line, strategy, mission, and objective. As per the interview, the agency is now developing the investment guide lines, policy, strategy, mission and objective and it is expected to be functional at the beginning of 2002 Ethiopian budget year. The capacity of handling the pension fund as per its choice of investment is some times backed by the Government. In addition, absence of enough employees who can administer the fund is one challenge in the management of pension fund. The objective of pension fund investment has failed to achieve since the pension payment can not improve the social and economic welfare of the pensioners.
3. Currently, pension fund investment has undertaken on the following assets: treasury bills, fixed time deposit, government bonds, corporate bonds and shares, demand deposit, real estate (under taken), and saving account (approved but not yet get implemented). The profit (return) from these assets is fairly attractive. The cost of investment is cheap. Earlier on, earning low return, limited expertise in the field and absence of financial markets were the challenges faced by the agency.

4. In the future, there will be more opportunities for the pension fund investment in Ethiopia (as 94.87% of the respondents replied). The following conditions are emphasized by the respondents that create great investment opportunities: globalization, the hope the stock exchange market will be established in the near future and the Government’s better and liberal investment policy.

5. As 87.18% of the respondents said, the Ethiopian Social Security Agency will face a challenge in the future related to pension fund investment practices. Some of the challenges as explained by the respondents are high government intervention; lack of clear investment guide lines, strategy, policy, objective, and mission; lack of due attention to the pension fund investment by the responsible bodies; problem of accessing capable professionals to assess and evaluate the available opportunities etc.

6. Even though all of the respondents have agreed on the benefits to be brought about by the establishment of the stock exchange market for pension fund investment in Ethiopia, only 28.82% of them have said the investment can not be feasible in the absence of the stock exchange market. That is, as 71.18% of
them replied, pension fund investment can be feasible on agriculture, construction, real estate, education, bonds and shares of government corporations like Telecommunication, Electric power corporations, etc. On the other hand, 56.51% of the respondents have agreed that the absence of organized stock exchange market can be considered as a challenge for pension fund investment, but the rest, 34.46% of the respondents said, right now there are untouched investment areas that can not await the establishment of stock exchange market; as a result the absence of stock exchange market can not be considered as a challenge.

7. Although most of the French speaking African countries have no specific investment policy, they discuss about it at the board of directors budget meetings. They made pension fund investment on the following areas: on business loans, shares and bonds of public and private organizations, real estate, and social areas like nursery, primary school and hospitals.

8. 41.03% of the respondents believed as there are qualified fund managers in the market (even though experience can be a problem for some time). The other respondents, 38.46%, said there are no fund manager who can effectively manage the pension fund and the rest (20.15%) gave no opinion about. The researcher believes that there may be problem of awareness on how the Ethiopian Pension fund is managed. But there are capable finance professionals ( of course unorganized) in the market

9. The English speaking African countries (Zambia, Kenya, Uganda, Zimbabwe, Mauritius and Nigeria) are better in terms of legal provision, investment plan,
investment criteria and others but not in Ethiopia even though all of them have common problems to share.

10. Proper management of pension fund will have a contributing role to economic development of the country, as all the respondents said. They said, the living standard of the retirees, capital mobilization from one sector to another, employment opportunity, and income distribution are some of the potential contributions.

11. The respondents have shown different opinions about the fiscal policy of Ethiopia whether it encourages the development of and economic contribution of pension fund investment. 20.15% of them said it encourages, 46.15% of them said it did not encourage, and the rest 33.33% gave no opinion.
5.2 RECOMMENDATIONS

Based on the findings and conclusions, the following suggestions and recommendations are given which may be valuable to the Government, the Agency, and to academicians and other professionals.

a. The ESSA has failed its objective “one of its objective being improving the life of the old aged people”. This has got a great link with government intervention on the management of the pension fund. There fore, government should limit its power and duty on managing and controlling the pension fund. The board members should include other concerned parties like the public servants, the pensioners associations and the Government. The director of the board should not be assigned by the Government rather the board members should select the director. The Government should design a controlling mechanism for the pension fund rather than directly controlling each activity of the agency. This makes the Agency to handle the pension fund per its choice of investment and increases the efficiency of the agency in managing the pension fund.

b. As indicated in the interview analysis section, the agency is developing pension fund investment policy, guideline, strategy, mission, and objective. But, since this document is approved by government assigned people, they may aligned it per the government’
c. Since the establishment of stock exchange market has a benefit to bring for the development of pension fund investment (that is, increase liquidity, increase the types of assets available, mobilizes the capital of the agency from one sector to another), Government should facilitate its establishment.

d. For proper management of the Pension fund, a thorough feasibility study is required on the suggested opportunities to be exploited and to forward a solution for the expected challenges or threats. This demands the employment of qualified professionals. There fore, the agency should equip itself by qualified finance professionals who can properly manage the pension fund, creating public awareness about the ESSA’s operation may be a potential solution to attract professionals to be employed tin the agency. Otherwise, outsourcing is always a solution at hand.

e. The Ethiopian social security agency should take the experiences of French speaking as well as English speaking African countries about the management of their pension fund. This may increase the confidence of the Agency to invest on the suggested areas by the respondents like construction, education, agriculture, hospital and others.

f. Finance Professionals (that may be academicians or practitioners) should organize them selves for related advisory services and for detailed study on the importance and economic contribution of organized Institutional investors in developing countries like Ethiopia.
Bibliography


(Available at http://www.igidr.ac.in)
Dear Respondents,

This is an endeavor to collect information about the practices and futures plans of pension fund management in Ethiopia. I intend to look into the opportunities and challenges of pension fund management in general and our own case in particular. Such exercise is believed to have positive contribution to both academic delivery and wisest & prudent handling of public finance.

Hence, I kindly ask you to share with me part of your valuable time by completing this questionnaire.

I thank you in advance.

Mengistu Gebru, Msc candidate (FBE, AAU)

Part-I: Respondents Profile

*Please fill in the blank spaces the information enquired.*

Sex ____________________________

Marital status ____________________

Academic Specialization(s) ________________

Current Work Place (Organization) ____________
Current Position in Your Organization ————
Acknowledgment

I would take this opportunity to thank my project advisor, Ato Abebe Yitayew (assistant Professor of Finance), for his valuable guidance, suggestion, and follow up through out this project. Without his committed assistance completing this project was unthinkable.

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I would like to that the staffs of Ethiopian social security Agency: Ato Fasil Tasew( manager of investment office), Ato Teshome Megersa ( investment head), Ato Amare Tadesse(Planning and programming head), and w/o Marta Mersha ( library head) for their polite assistance by providing the materials necessary for the project.

Last but not least, to my brothers (brotherly friends): Abegaz, Yidersal, Tsega, and Teshome I thank you very much for all you did to me through out this couple of years.