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102

financiamiento del desarrollo

Pension funds and the financing productive investment

An analysis based on Brazil's recent experience

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Contents

Tables

Figures

Abstract

This paper analyzes the recent development of pension funds in Brazil in the 1990s (and especially in the second half of this decade). It draws lessons from Brazil's recent experience to assess the potential of these institutions as suppliers of funds to productive investment and to discuss policies that could possibly enhance and make effective this potential.

It concludes that pension fund reforms are important potential suppliers of long-term non-inflationary financing to productive investment. Low inflation and sustained macroeconomic stability are important (even necessary conditions) for the enhancement of this. But they do not seem to be a sufficient condition. In economies where capital markets are shallow and/or inherently volatile, additional institutional and regulatory arrangements need be created in order to stimulate the channeling of long-term funds of pension funds towards the acquisition of newly issued corporate securities.

There seems to be a wide variety of possible regulatory and institutional arrangements, and in this paper we explore one of them.

Introduction

Private pension funds in Brazil were first regulated in 1977, but it was not until the 1990s that they began assuming a prominent role in the Brazilian financial system. Given the size of its current portfolio (over US$ 90 billion and more than 12% of GDP in December 1998), how these institutions allocate the portfolio does have important impact on different financial markets and on the flows of funds to different economic agents.

In most developed economies, pension funds play a significant role in the provision of long-term funds to the corporate sector. The mechanisms through which this intermediation takes place vary significantly (Table 1): in those economies where capital markets are robust and large (for instance in the United States), pension funds acquire, directly or indirectly, long-term securities, stimulating simultaneously the primary and secondary capital markets. In developed economies dominated by universal banks, pension funds acquire long-term bonds (certificates of deposits, for instance) issued by banks, allowing the latter to provide their corporate clients with loans with different maturities.

This has not been the reality in most developing countries. In Brazil, specifically, pension funds had, until recently, a minor role as providers of long-term funds to productive investors, as most of their resources were directed to the financing of public debt and the acquisition of real assets, such as real state. This behaviour, as we shall argue in this paper, has to do with at least five aspects of the Brazilian macroeconomy and the functioning of its financial markets:

- ✓ High inflation and macroeconomic instability, which led to highly uncertain financial environment and to *short-termist* behavior of most financially surplus units in the country;
- ✓ High levels of public debt, financed by issuance of highly remunerated government bonds;
- ✓ The existence of relatively easy access (for large companies) to long-term, subsidized credit from public institutions
- ✓ Too much volatility of asset prices both in the short and medium run, which makes institutional investors reluctant to invest;
- ✓ The lack of appropriate regulatory arrangements and institutions to stimulate the direct acquisition of corporate securities by pension funds, or to channel their savings towards the financing of productive investment.

Table 1
PORTFOLIO DISTRIBUTION OF PENSION FUNDS IN SELECTED COUNTRIES 1990
(Percentage)

Country	Sight and other bank deposits	Bonds	Loans	Real state	Stock
United Kingdom	7	14	0	9	63(70)[a]
USA	9	36	0	na	46(48)
Germany	2	25	36	6	18(18)
Japan	3	47	13	2	27(27)
Canada	11	47	0	3	29(38)
Sweden	3	84	10	1	1
Switzerland	12	29	14	17	16
Denmark	1	67	1	na	7
France	na	na	na	na	(20)
Australia	23	20	na	16	27
Memo: Italy	21	45	1	32	2

Source : Rabelo (1997: 39). Obs: (a) 1994 data; na= not available.

In the 1990s, Brazil's financial system, as well as its macroeconomics, went through significant changes, stimulated by shifts in domestic regulation, external liberalization and the achievement of price stability in mid-1994. These changes created a new macroeconomic environment (of low inflation and rapid growth of the securities market) and a new regulatory setting in which pension funds operate. Even though this new environment proved to be a necessary condition for asset diversification and for the widening of the maturities of assets held by pension funds, it was