INVESTING IN INFRASTRUCTURE: STRATEGIES FOR KEEPING IT PUBLIC

For many years, CUPE has been critical of the fact that governments are not investing adequately in public infrastructure. In fact, many governments have cut expenditures to the public infrastructure that citizens depend on - municipal water treatment, provincial highways, universities, schools, recreation facilities, and hospitals.

As the infrastructure crumbles, awareness and calls for renewal have increased among user groups, workers, and the general public. In light of rising energy costs, and the Kyoto Protocol obligations the need for re-investment is becoming more pressing.

However, rather than responding with comprehensive plans for increases in funding, most governments are seeking ways to avoid this responsibility by handing over the ownership and control of vital infrastructure to private management, and even ownership, through “public-private partnerships” (P3s).

The public investment which has built Canadian infrastructure throughout our history is being abandoned by policy makers. Instead, P3s are being promoted as an easy solution to the investment problem. Governments who promote P3 infrastructure argue that they are unable to afford the investment required, and that the private partners can deliver a package of technology, expertise, capital and commercial networks that governments cannot.

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CUPE rejects these claims. We have proof that P3s:

- strip away the democratic accountability of public management;
- introduce the profit motive into the delivery of essential public goods – an obvious conflict with the public interest;
- are far more expensive than public investment, since the private sector simply cannot borrow money as cheaply as governments can; and
- undermine wages and working conditions for public sector workers.

We support these points with detailed analyses of specific P3 projects like the Confederation Bridge, the Evergreen School in New Brunswick, the Moncton/Fredericton Toll Highway, and legal analyses that show how infrastructure privatization feeds the goals of trade and investment agreements like the North American Free Trade Agreement (NAFTA) and the General Agreement on Trade in Services (GATS)(see www.cupe.ca for these analyses).

In 2003, CUPE commissioned two research papers on this topic, one focused on infrastructure finance alternatives, and the other examined the role of workers' pension funds in infrastructure investment and renewal. This is a summary of these two papers:

1. Alternative Methods of Public Financing of Infrastructure in Canada – Enid Slack

Enid Slack's study of infrastructure financing focuses on local governments, beginning with an overview of existing arrangements and needs. She confirms what many CUPE members and Canadians know already – there is a "deficit" in infrastructure investment, and an urgent need for upgrading and renewal across the country.

A comprehensive assessment of this deficit has not yet been performed, but the report quotes several studies that have estimated the needs at:

- "tens of billions" for water treatment (Federation of Canadian Municipalities);
- $44 billion for municipal infrastructure (Association of Consulting Engineers of Canada);
- $13 billion for transit alone (Canadian Urban Transit Association).

Current Municipal Infrastructure Investment

Current patterns of municipal infrastructure investment (or "capital expenditure"), indicate that governments' largest investment category is transportation, followed by environmental services (water, sewers, and waste), and then recreation and culture.

Sources of financing include "own funds" (direct revenues and reserves), federal and provincial grants, and borrowing. In reviewing available statistics on borrowing, Slack shows that municipalities' recent aversion to debt has changed the way they operate:

> "What is most striking…is the decline in debt charges over the 13-year period [1988-2001]. These estimates suggest that **municipalities have considerable capacity to borrow** in many provinces, with the possible exception of Newfoundland where borrowing costs have fallen over the last 12 years but are still the highest in the country."(p. 9)

This may surprise many Canadians, after years of being told by politicians and the media that governments are over-burdened by debt. The report shows that municipalities have reduced their borrowing over the last decade, and

> "…are relying more heavily on contributions from "own funds" (property taxes, user fees, and development charges) to finance capital expenditures." (p. 11)

Slack examined the existing revenue sources of municipalities and found that the three largest categories are:

- Property taxes 42%
- User Fees 23%
- Federal/Provincial Grants 17%

Slack refers to property taxes and user fees as "regressive" ways to generate revenue because they are not geared to income, so the rich and the poor pay the same rates. In the case of user fees, she points out that:

> "…the main reason for the increased reliance of municipalities on user fees has been budgetary pressures," and points out that "low income families cannot afford to pay user fees and will either not use the services or will have to reduce their consumption of other services." (p. 15)

One remedy is the application of 'lifeline' pricing, which gives everyone access to an initial basic quantity of the service at low prices or at no charge.

Infrastructure Investment Alternatives

CUPE opposes P3s because we believe proven methods of public investment work better. We believe that:

- governments should seek revenues through the most progressive and fairest mechanisms possible;
- public borrowing and debt can be easily and equitably sustained by spreading the cost of capital expenditure over a longer period of time;
- workers' pension funds are an untapped source of patient, long-term loan capital.

The Slack study reinforces this view, and adds several policy options:

1) **"Pooling" borrowing power** in institutions such as the BC Municipal Finance Authority. This allows local governments, both big and small, access to loans at cheaper rates. More and more provinces now have such institutions, but many smaller municipalities still don't have access to such a tool.

2) **Tax exempt bonds** such as those offered by the Ontario Municipal Infrastructure Financing Authority (OMIFA) as Ontario Opportunity Bonds are another viable option as long as they provide financing that is publicly owned and controlled. All Ontario municipalities are eligible to apply for loans from OMIFA. As Slack points out, however, this option is regressive because:

> "…high income taxpayers are more likely to benefit because they have the funds to invest…Moreover, for a given amount invested, the benefits are larger for taxpayers with a higher marginal tax rate." (p. 23)

Nonetheless, the first issue of these Opportunity Bonds exceeded expectations.

3) **Dedicated fuel tax** is another option discussed by Slack. Many Canadian municipalities are now demanding greater direct transfers of both federal and provincial fuel taxes. Slack notes that this is already done to some degree by provincial governments in BC, Alberta, and Quebec to finance transportation priorities. The downside of this option for local governments is that the federal and provincial governments control fuel taxes, so their continued cooperation is required.

4) **Tax Increment Financing Districts (TIFs),** were developed in the US to stimulate investment in blighted urban areas. TIFs are zones of activity where capital improvements are made by a government, and paid back from increased property tax revenues generated by the improvements. Slack notes that while TIFs pose design challenges, they have proven useful in stimulating compact downtown development and reclaiming of toxic sites (called "brownfield" remediation).

2. The Role of Pension Funds in Financing Investment in Public Infrastructure – Monica Townson

CUPE challenges the claim that governments should not be borrowing, and have no access to capital. In fact, the pension funds of CUPE members represent hundreds of billions of dollars of investment capital, some of which could be harnessed for investment in critical infrastructure. Workers' pension funds have played a positive, passive role in infrastructure renewal when they have bought government bonds. This role could be enhanced if our plans were more proactive.

To provide more information on how this might best be done, CUPE commissioned a second research report in 2003, by economist Monica Townson, on the investment of pension funds in public infrastructure.

The study begins with a strong assertion of the importance of public infrastructure, and the serious economic costs of its erosion.

> "It has been suggested that the slowdown in public infrastructure investment can help explain a significant portion of the slump in productivity growth in the past two decades. Public investment in infrastructure is also critical to economic growth. But the value of public investment in these public goods such as roads, bridges, recreation centres and community facilities, transportation, schools and hospitals, does not appear in government accounts…Accounting practices fail to acknowledge the importance of the public assets acquired through public infrastructure investment and leave the impression that investment in infrastructure is simply a "cost" with no "benefit" to show for it." (p.1)

Townson also provides a brief history of infrastructure finance, pointing out that the post-war "welfare state", and the significant physical capital that came with it (in the form of new hospitals, schools, and other public facilities) were generally publicly financed. It has only been in the past 20 years that this role for government has been significantly withdrawn in response to the argument that these public goods ought to be owned and operated by the private sector.

Townson points out one revealing illustration of this trend - the amendment of the investment policy for the $56+ billion dollar CPP (Canada Pension Plan) reserve fund. From the establishment of the CPP in 1966, this fund was invested entirely in provincial bonds used to finance local governments, schools, hospitals, universities, roads, and other public priorities. The bonds held by the CPP paid a reasonable, federal government rate of return. However, in 1998, the federal government radically changed this policy by moving into a diversified stock and bond portfolio instead – thereby eliminating one of the largest, proven, public sector infrastructure investment mechanisms available. The government attempted to justify this change on the grounds that greater income was needed for the CPP fund, to meet demographic pressures. They said "privatized" fund investment would generate greater returns.

The result is that the primary model for pension fund financing of public infrastructure has been deliberately eliminated. Moreover, the decision was entrenched in legislation, which makes it harder to change.

Townson cites the CPP Investment Board's policy:

> "Our legislation specifically prohibits us from engaging in any investment activities other than maximizing returns without undue risk of loss. Consequently, we do not select or exclude investments through the application of

> positive or negative screens based upon religious, social, economic, political, or personal criteria, or any other non-investment criteria." (p.27)

Towson's study also reports on the CPP's investment in Borealis, an infrastructure investment company established by OMERS (the Ontario Municipal Employees Plan) that is devoted to P3s. While the CPP has recently divested its stake in Borealis, it remains a real problem that the CPP has transformed its investment policy from a textbook model of public sector investment into yet another powerful force for privatization.

Fiduciary Obligations of Pension Plan Trustees

CUPE recognizes the fiduciary obligations of pension trustees to achieve reasonable returns for plan members. However, we reject the narrow interpretation of these duties promoted by Bay St. and much of the employer-dominated pension industry. The duty of loyalty to the interest of the beneficiary must be broadly understood – as several legal precedents have insisted. For us, this means that consideration must be given to a broader definition of the interest of pension plan members to include good jobs, decent working conditions, and a healthy community in which to live.

Townson's examination of fiduciary duties supports this view. She argues that:

> "Pension funds can play a positive role in helping finance public infrastructure, providing a good rate of return for pension plan members while at the same time assuring governments of capital at reasonable rates." (p. 26)

She cites the case of the New York City teachers' plan where the courts upheld the trustees' decision to protect members' employment interest by investing in municipal bonds at concessionary rates.

However, the report notes there are challenges to achieving this. First of all, many plan members still exercise very little control over their pension plans. Joint trusteeship, while increasingly a feature of many CUPE member plans, is still not the norm. Even where joint control is established, not all trustees – particularly those named by the employer – share CUPE's concern for public-minded investment priorities. Finally, some plans (as in the CPP example) impose restrictions on any investment policy not justified on narrow financial grounds.

Nonetheless, Townson points to several models to build on. In the United States, a Housing Investment Trust (HIT) was established in 1965 with a mandate to both pool pension fund assets for investment in affordable housing, while at the same time creating jobs for union members in building trades.

A similar model exists in Canada. Concert Properties (formerly Greystone), is the investment arm for a group of jointly-trusteed BC pension plans which has been building and managing rental housing in BC for about 15 years. Concert uses union labour only, and is now the largest developer of rental housing in western Canada. As successful as it is though, Concert is an example of <u>private</u> infrastructure development – not public.

Strategies to Encourage Pension Fund Investment in Public Infrastructure

Townson's study offers several strategies for pension investment in public infrastructure:

1) **Renewing public funding of public infrastructure** - The study urges CUPE to continue pressuring governments to return to their previous role in issuing bonds to finance public projects. Greater innovation is always possible, and Townson points out that:

> "…governments might be persuaded to issue special bonds to fund infrastructure projects or to develop their own funds or financing vehicles that would achieve this result." (p. 35)

First, Townson says governments need to overcome "their aversion to debt and borrowing."

This may also require pension funds to shift their asset mixes back to their former preference for secure, long-term government bonds. This may be more likely now that the risks of the equity markets have become so obvious.

2) **Real Return Bonds** - One instrument that has been under-utilized is the real return bond – a bond with returns that are linked to future rates of inflation. While governments have been reluctant to offer them, they are an excellent mechanism for channeling money specifically to infrastructure projects, which are inherently long-term. Some of the existing bonds are attached to P3 projects (such as Highway 407 and the PEI Confederation Bridge), but this feature could be reversed, with a requirement added that the proceeds of such bonds can only be used to finance infrastructure that will remain public.

3) **Green Infrastructure Fund -** Similar to the idea outlined in the Slack report, a Green Infrastructure Fund could serve as a pooling mechanism for multiple pension funds:

> "Attractive interest rates and effective marketing could make such instruments appealing to pension funds. Buying bonds issued by such a fund would generate monies, which the federal government could then distribute to junior levels of government, for investment in infrastructure to promote safe and clean environments." (p. 38)

4) **Tax Exempt Bonds -** Townson also refers to this model, and cites Ontario's Opportunity Bonds as a good example. She notes the same problems as Slack, and points out that such a tool would need to be refined to appeal to pension funds, which already benefit from tax-free earnings.

5) **The Crown Corporation Model -** Townson suggests the possibility of establishing an Infrastructure Crown Corporation similar to the CMHC. This body could be empowered – like the CMHC – to issue bonds, and thereby pool funding for particular infrastructure projects. Again, criteria of public ownership should be incorporated into the design of such a body, so that it would not be used to finance privatization.

6) **Regulation -** While admittedly a likely "nonstarter", Townson points out that pension legislation and regulation itself could actually require pension funds to hold a certain percentage of assets in public infrastructure (by way of government bonds), just as the government has chosen to impose a 30% cap on foreign investment.

7) **Pension Trustee Education -** Townson points out that pension trustees are often trained or advised by consultants and professionals who may not share CUPE's perspective on public investment priorities and their consistency with fiduciary duty. More trustee education from a labour perspective is needed to counter these pressures. CUPE has attempted to meet this need by developing a week-long course for pension trustees that will prepare them to discuss the issues raised by this debate. In particular, this course provides trustees with the background information needed to press for a positive, pro-public sector investment policy for their plan.

8) **Public Communication -** We need to continue to get our message out about the higher costs, the risks, and the downsides of P3s and privatization, and using pension funds to finance public investment in infrastructure.

CONCLUSION – THERE ARE ALTERNATIVES!

These two studies reinforce CUPE's argument that there <u>are</u> viable alternatives to P3s. The fact that public sector finance and management has been repeatedly shown to be more efficient, cost effective and accountable than privately run enterprises, is a strong argument for keeping vital public infrastructure in public hands. The existing "deficit" – resulting from years of underinvestment – must not be used as an excuse for selling off our collectively owned assets to the highest corporate bidder. To do so is reckless, inefficient, and undemocratic.

CUPE is doing our part to encourage our pension funds to seek out a proactive role in this debate, however, ultimately decision-making rests with governments. As Townson points out:

> "Since public infrastructure necessarily implies public ownership, successful strategies may ultimately depend on action at the political level to persuade governments that public borrowing to finance the investment and renewal of public infrastructure is a desirable and indeed preferable approach to this urgent problem." (p. 44)

REFERENCES

Slack, E. "Alternative Methods of Public Financing of Infrastructure in Canada," Commissioned by the Canadian Union of Public Employees, June 2003;

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