

A CUPE BACKGROUNDER ON URBAN INFRASTRUCTURE

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EXECUTIVE SUMMARY

1. Research into the state of urban infrastructure confirms the importance of public services in Canada. Governments, including local governments, provide services to ensure a high quality of life in our communities. They have brought services into the public arena in order to meet basic human needs, protect health and safety and advance other important social policy objectives.
2. Our urban centres are richer in every manner by the fact that we have experienced steady immigration flows into our major cities. Immigrant workers have contributed greatly to the development of our cities both economically and culturally – they have built our cities into the vibrant places they are today.
3. Canada's publicly-owned infrastructure has a positive impact on the productivity and economic performance of the Canadian business sector. Our roads, mass transit, water supplies, wastewater treatment facilities, power plants, bridges, ports, telecommunications and airports – all play a part in improving the overall economy.
4. When countries like Canada moved to decrease government spending, investment in important infrastructure like bridges, roads, and urban developments like affordable housing suffered. The Federation of Canadian Municipalities (FCM) estimated Canada's infrastructure deficit to be as high as \$60 billion and growing by approximately \$2 billion a year.
5. Municipalities have to spend huge amounts on capital projects, including transportation, the environment, recreation and culture.
6. Cities have to pay for large capital expenditures by various methods, including property taxes, special assessments, user fee in some cases, "green taxes" or consumption taxes, through federal and provincial grants, development charges, public borrowing and increasingly by entering into public-private partnerships. In general, municipalities have been relying on contributions from their own funds, which include property taxes, user fees, and development charges, in order to finance their capital expenditures.
7. Municipalities have considerable capacity to borrow in most provinces.
8. There are major problems with P3 financing, operations and accountability. Public-private partnerships cost governments more in the long run; they sometimes hide but never reduce public debt. Clearly, private corporations have to show a profit for their shareholders and this results in higher costs for the public. PPPs result in reduced quality of service and reduced wages. The experience of PPPs also shows that there is reduced transparency and reduced public control. Finally, it is clear that a majority of Canadians want their public infrastructure built through direct public investment, not PPPs.

9. Governments are the most secure and efficient borrower for major infrastructure investment. Public borrowing is clearly a far more fiscally and socially responsible choice for municipalities when it comes to financing capital projects.
10. Pension funds are in a position to play a positive role in helping finance public infrastructure by providing a decent rate of return for pension plan members and at the same time assure governments capital at a reasonable rate. If a pension plan can find alternative investments that are equally sound and that generate equivalent returns, this approach makes sense. Hence, pension funds need to be encouraged to invest in public infrastructure.
11. There are many other alternatives for funding infrastructure, including the pooling of municipal debt, government bonds, real return bonds, a dedicated Infrastructure Fund at the national level, tax-exempt bonds, subsidies from senior levels of government, crown corporations on the model of the Canada Mortgage and Housing Corporation and possibly Public Interest Companies (PICs).
12. All of the above confirms the necessity to support the proposed “New Deal for Municipalities” in order to ensure permanent sources of revenue to rebuild infrastructure and in order to maintain a high quality of public services throughout our cities and municipalities across Canada. Canadian municipalities need and deserve secure and stable sources of predictable revenue, such as a dedicated portion of the federal fuel tax.

Canadian communities reflect the inequalities, which exist in the country as a whole. The widening gap between rich and poor is threatening our social fabric. At the same time, crumbling urban infrastructure and chronic under-funding of public services means a poorer quality of life for all communities. It is past time for a new deal that improves democratic control, protects our quality of life, supports quality public services and rebuilds our cities and communities.

INTRODUCTION

The Canadian Union of Public Employees (CUPE) represents over 530,000 members in communities throughout Canada and has consistently fought for a fair deal for our cities and communities.

In 2001, we said the following: “our towns and cities are feeling the worst impact of globalization, downloading, funding cuts, restructuring, and amalgamations – and this means CUPE needs to take on the new challenges facing our communities in a new way” (CUPE Convention paper - *Taking Back our Communities*). Since then, the situation, especially for urban centres, has deteriorated further. A shrinking financial base has caused many cities to forgo important new investments in infrastructure and many are struggling to find new ways of financing investments and services. Canada is facing a major urban crisis. Mayors from major municipalities have begun mobilizing to get a “new deal” for their respective cities and in his February 2004 Throne Speech, Prime Minister Paul Martin, outlined his version of a “New Deal for Communities”. It is important to lay out CUPE’s vision for rebuilding strong communities.

THE STATUS OF OUR CITIES AND COMMUNITIES

The History of Municipalities and Public Services

Public services have played a major role in most societies throughout world history and in virtually all countries in the past century. During most of the 19th century, public ownership and public provision prevailed mostly because of the inefficiency, costs and corruption involved in the private system. The main instrument, or mechanism for public provision was local and municipal management control.

Governments including local governments provide services to ensure a certain quality of life in our communities. They have brought services into the public arena in order to meet basic human needs, protect health and safety and advance other important social policy objectives. Public services have become key determinants of the quality of life in communities precisely because the private sector could not or would not deliver the services at a high enough quality and at an affordable cost to the people who live and work in these communities.

Canadian communities, and in particular our cities, have recently become centres of vibrant cultural, economic, and social activity, cultivated and nourished by public ownership and control.

Urbanization in Canada

Canada has had a proud history of immigration. The influx of new immigrants in the late 1800s and early 1900s, resource settlement, the establishment of transportation corridors and industrial expansion – all of this has made Canada one of the most urbanized countries in the world today. There are both positive and negative effects of this expansion, evident especially in the past few decades. Over 80% of Canadians live in cities and the vast majority live in four large metropolitan areas – Greater Toronto, Greater Montreal, Southwestern British Columbia, and the Calgary-Edmonton corridor. These and other large urban centres have become extremely important determinants of economic, social and cultural growth in Canada. They still absorb the vast majority of immigrants to Canada and play a tremendous role in assisting immigration settlement. Immigrant workers have contributed greatly to the development of our cities both economically and culturally – they have built our cities into the vibrant places they are today. Almost 40% of the population in Toronto and Vancouver are persons of colour and, although this number does not represent only immigrants to Canada, it is a fact worth celebrating. Similarly, in Saskatchewan and other provinces and territories, First Nations peoples constitute a significant percentage of the population in the cities and communities throughout the province. Aboriginal people make up about 12.5% of the Saskatchewan population, although only 2% of the workforce. By the year 2045 the Aboriginal population will grow to 32% of the provincial population.

The importance of CUPE members to the vibrant growth of cities and communities cannot be overstated. In every centre – small or large – it is CUPE members who are the frontline of the face the cities and communities present, to the Canadian and international community. Whether it be at the front desk in municipalities, or on the job recycling waste, tending to the sick and the elderly, assisting in schools and libraries, keeping water safe and clean, working with immigrant families – in whatever capacity, CUPE members contribute greatly to the wealth and health of communities throughout Canada.

Cities remain the centre of economic growth, economic growth which stems not only from resources, manufacturing, and newer knowledge-based industries, but also investment in health, social services, education, housing, and other public infrastructure like roads and public transit, water treatment and solid waste disposal. The major communities have been the lifeblood for building a high quality of life, a quality of life which includes a strong movement towards a cleaner environment, outstanding cultural and recreation opportunities, and livable communities. Montreal accounts for 49% of Quebec's GDP, Winnipeg accounts for 67% in Manitoba, Vancouver for 53% in British Columbia, Calgary and Edmonton together account for 64% of Alberta's GDP, Halifax accounts for 47% of Nova Scotia's GDP and Toronto accounts for 44% of Ontario's GDP (and 20% of the GDP of Canada as a whole).¹

¹ Enid Slack, "Alternative Methods of Public Financing of Infrastructure in Canada p.17

Canadian cities, like large cities throughout the world, have also become the face of the increasing gap between the rich and poor in our society. Poverty, homelessness, racism and unemployment, crumbling infrastructure and crowded facilities – these have all accompanied the rise in the level of wealth for some. Cities have borne the greatest share of all of these problems while at the same time they have been the greatest engines of growth for the entire economy.

The David Suzuki Foundation recently highlighted the problems Canadian cities have inherited over the past half-century, including urban sprawl, a car-dependent culture, air pollution, and gridlock.² The report also documented how between 1966 and 1986 more than 3,000 square kilometers of rural land, mostly prime agricultural land, was lost to sprawl. It costs more to accommodate growth by building new roads, electrical lines, sewer and water infrastructure for new subdivisions and shopping centres, than to integrate people into existing areas (generally referred to as “densification”). Greater densification is the most efficient option not only because it results in the best use of existing infrastructure, but also because new densification investments are more likely to be made in renewal of existing infrastructure than in construction of wholly new assets.

According to the Suzuki Foundation, urban sprawl will cost Greater Toronto \$69 billion in the next 25 years, unless steps are taken to make the city more compact and to improve transportation and to improve or ameliorate air quality. Canada is the only major industrialized country without a national program for supporting urban transit. Gridlock in Toronto costs approximately \$2 billion a year in lost productivity.³ We need to look seriously at how to overcome these problems. The financial and environmental crisis facing our communities needs immediate attention.

The Importance of Infrastructure to our Overall Economy

Two studies recently released by Statistics Canada show clearly that Canada’s publicly-owned infrastructure – our roads, mass transit, water supplies, wastewater treatment facilities, power plants, bridges, ports, telecommunications and airports – has a positive impact on the productivity and economic performance of the Canadian business sector. They also show how the federal government has increasingly abandoned its responsibility to provide infrastructure directly.⁴

² Sustainability Within a Generation: A New Vision for Canada, David Suzuki Foundation, February 2004, Introduction , p.31

³ David Suzuki Foundation, p. 31

⁴ Public Infrastructure and the Performance of the Canadian Economy, 1961 – 2000, a summary of 2 research papers available on the Statistics Canada web-site: www.statcan.ca/Daily/English/031112/d031112a.htm

Public infrastructure, or “public capital” lowers the cost of producing a given level of output in almost every Canadian industry within the business sector. For example, a well-constructed highway allows a truck driver to avoid back roads and get the goods to market in less time. The reduced time means that the producer has a lower cost and the truck experiences less wear and tear. So, public investment in this highway enables private companies to produce their goods at a lower total cost.

The Statistics Canada economic study demonstrates that within the business sector as a whole, every \$1 increase spent on infrastructure generated, on average, approximately 17 cents of cost-savings each year from 1961 to 2000.

However, public capital investment has not kept pace with the growing economy – there is an “infrastructure crisis”. The studies highlight the relative decline of federal government contributions and the increased responsibilities of provinces and municipalities for infrastructure across the country (likely attributable to the federal government’s retreat from direct responsibility for infrastructure such as urban transit, housing, ports and airports). Since the early 1960s, the bulk of public infrastructure capital stock has been under the ownership of provincial and local governments (45.3% and 30.9%) compared to about 25% for the federal government. In 2002, local government accounted for more than 50% of total public infrastructure, compared to 40.8% for provincial governments and a mere 6.8% for the federal government.

Capital Stock of Public Administrations in Canada							
	Total	Federal		Provincial		Local	
	\$ billion	\$ billion	%	\$ billion	%	\$ billion	%
1961	9.3	2.2	23.9	4.2	45.3	2.9	30.9
1973	29.2	4.4	15.1	14.6	50.1	10.2	34.8
1979	64.4	7.7	12.0	33.2	51.5	23.6	36.6
1988	113.7	10.9	9.6	54.4	47.8	48.5	42.6
2000	155.2	11.2	7.2	65.1	41.9	78.9	50.9
2002	157.3	10.6	6.8	64.3	40.8	82.4	52.4
Note: Net of linear depreciation.							

Source: Statistics Canada Study

Municipalities collect only 8% of all taxes levied by governments in Canada, 55% of which comes from property taxes. Canadian municipalities are extremely dependent upon the evolution of the real estate market but do not tend to benefit from the economic growth generated within each community.

These two Statistics Canada studies highlight how important public infrastructure is to the Canadian economy as well as the extent to which the burden of providing that infrastructure has increasingly fallen to local and provincial governments.

First, the federal government cut the deficit and the debt by cutting transfers to the provinces, and the provinces responded by cutting support to municipalities. As a result, cities have been forced to play a much greater and more direct role in the delivery of social services and the development of affordable housing, for example.

Proportionately, cities have had a shrinking financial base. Cities get only 8 cents out of every \$1 we pay in taxes in Canada, and this share is going down.

The Critical State of Infrastructure in Canada

As conservative ideology began to take hold in the 1980s, in particular, preoccupation with debt and deficits also gained momentum and dominated public policy discussions and decisions in Canada and elsewhere. Government spending was treated with suspicion in this new environment.

As countries like Canada moved in the direction of decreased government spending, the public sector retreated from investment in important infrastructure like bridges, roads, and urban developments like affordable housing. Recently, the Federation of Canadian Municipalities (FCM) estimated Canada's infrastructure deficit to be as high as \$60 billion and growing by approximately \$2 billion a year.⁵

As CUPE stated in its *Annual Report on Privatization* in 2000, "there is a strong case for public reinvestment in public services. Mounting evidence from Canada and around the world shows private, for-profit services are an expensive and ultimately destructive choice. To let services wither and die is equally destructive for Canada's economy and quality of life. The need for new public funding to strengthen public services is urgent".⁶

HOW DO CITIES AND COMMUNITIES SPEND ON CAPITAL PROJECTS?

Municipal Capital Expenditures

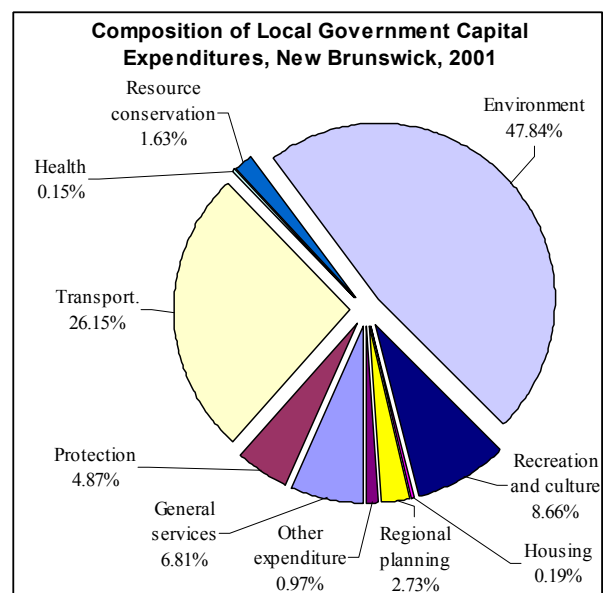
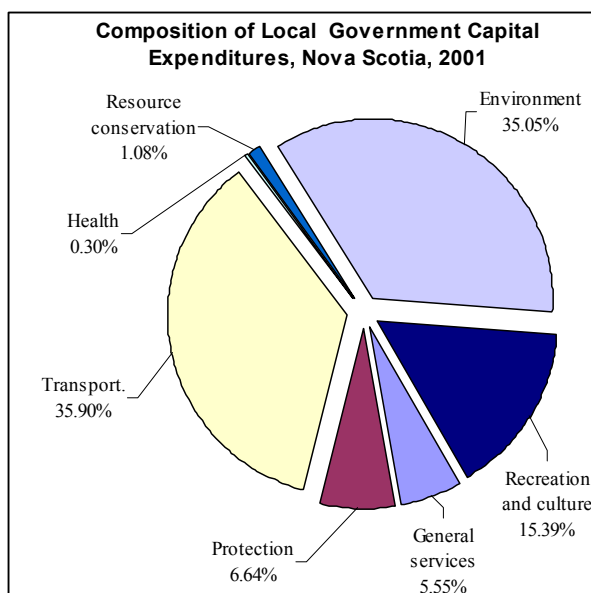
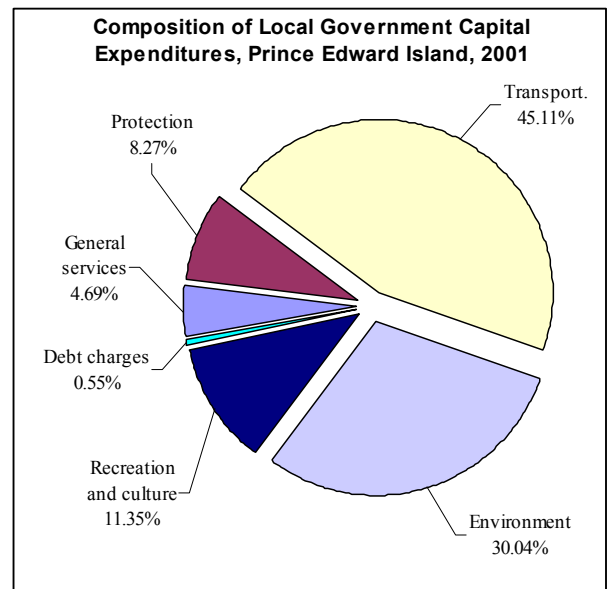
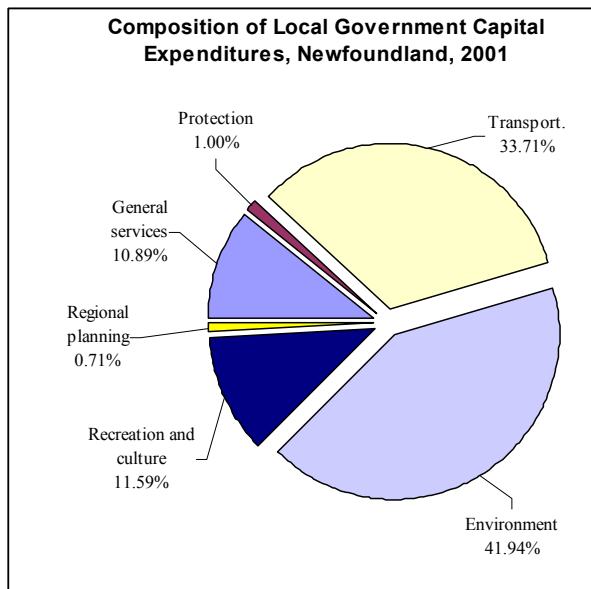
In 2001, municipal capital expenditures were estimated to be almost \$8.9 billion.⁷ up from \$6.3 billion in 1988. While governments generally increase operating budgets each year in order to keep up with inflation, service demand and population growth patterns of investment for capital are less consistent and fluctuate on a year-to-year basis. (For capital expenditure patterns, see figure 1)

⁵ FCM – web-site

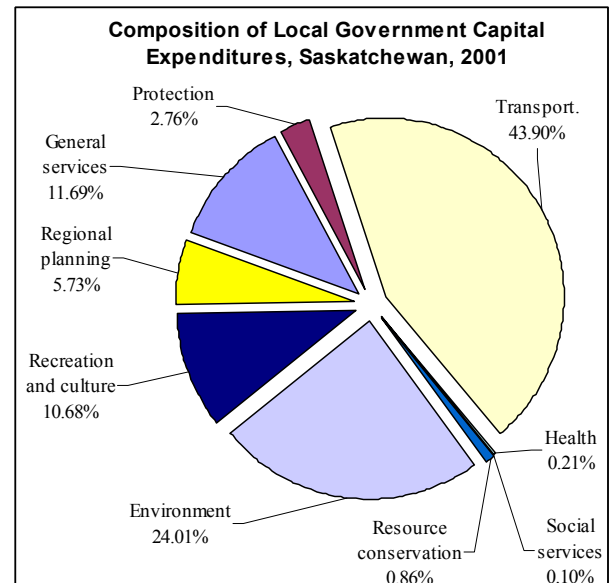
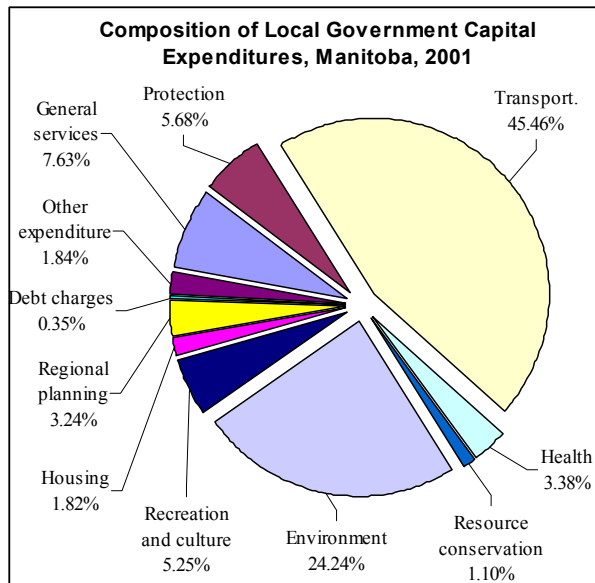
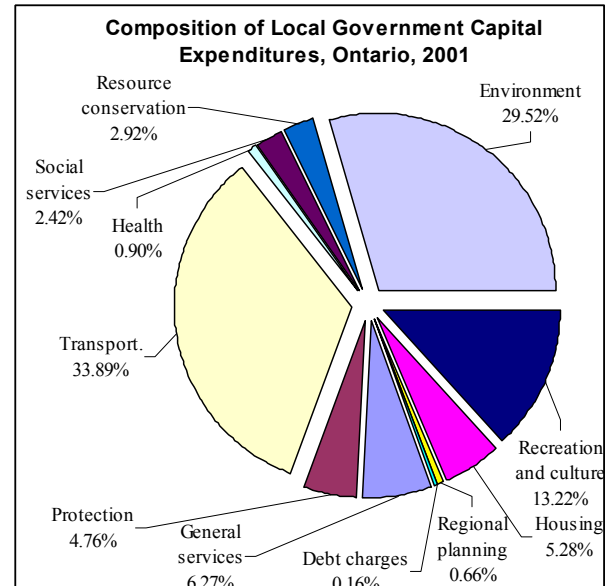
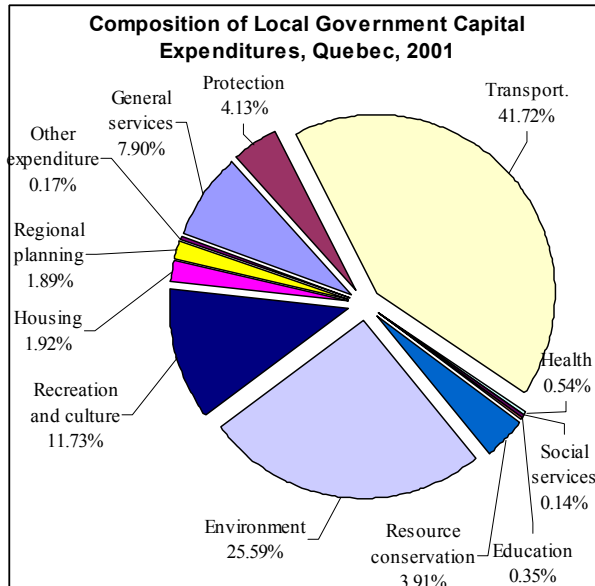
⁶ *CUPE Annual Report on Privatization*, 2000, viii

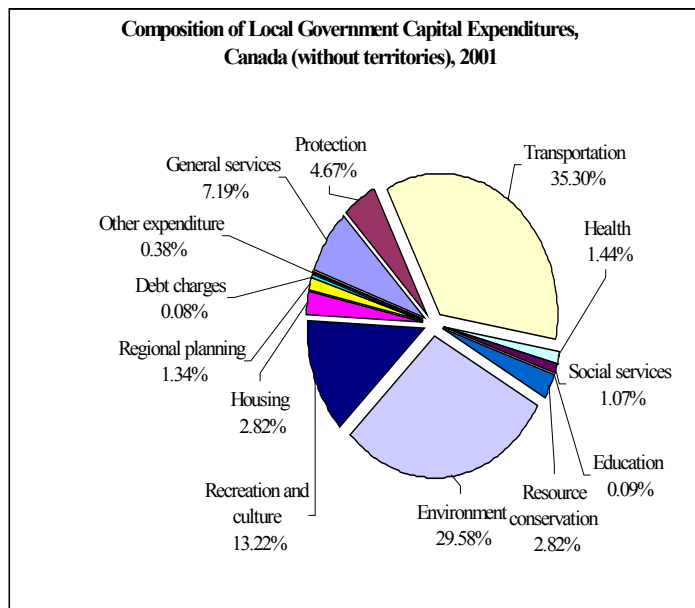
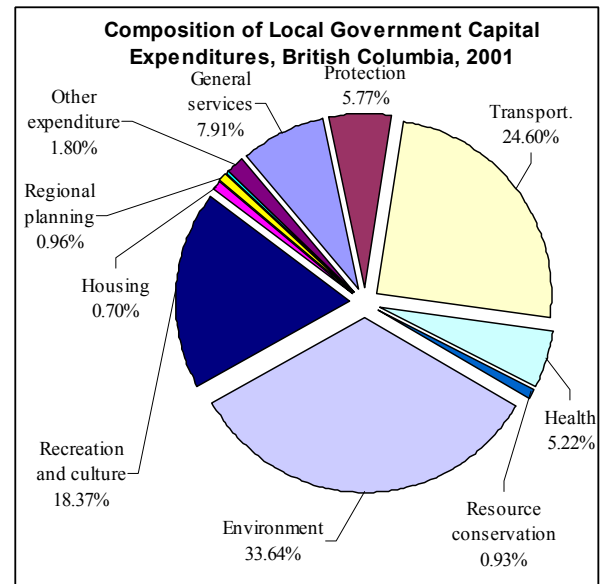
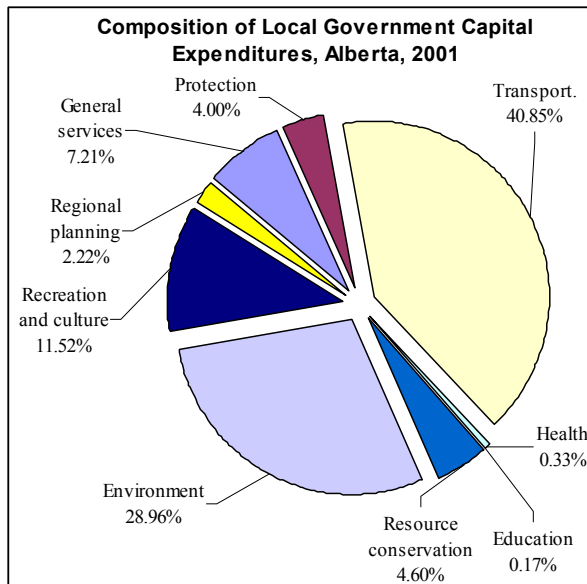
⁷ Enid Slack, p.4

Figure 1: Composition of Local Government Capital Expenditures by Province, 2001⁸



⁸ Enid Slack, p. 5,6





Source: Derived from Statistics Canada Public Institutions Division. Financial Management Systems (FMS) data.

Figure 1 shows the breakdown of local capital expenditures by individual function for Canada and each of the provinces for 2001. Transportation (roads and transit) accounts for the largest share of capital expenditures (35.3%), followed by environment (water, sewers, and solid waste) at almost 30%, then recreation and culture at only 13.2%. The remaining capital expenditures are divided among general services (administration), protection (fire and police), housing, resource conservation, and small expenditure items. The pattern of expenditure was similar in municipalities across Canada. However, in Newfoundland and British Columbia, capital expenditures were highest in 2001 in the area of environment (water, sewers and waste).

HOW DO CITIES PAY FOR CAPITAL EXPENDITURES?

Capital expenditures are financed in the following ways:

- municipalities “own funds” (revenue funds, reserves and reserve funds);
- federal and provincial grants;
- borrowing.

Municipalities have generally seen a decline in grants from senior levels of government in recent years. However, it is also clear that they have reduced their borrowing costs over the last decade. Municipalities have in fact, considerable capacity to borrow in most provinces, except Newfoundland. In general, municipalities have been relying on contributions from their own funds, which include property taxes, user fees, and development charges, in order to finance their capital expenditures.⁹

Current Methods of Paying for Municipal Capital Expenditures in Canada

a) Property Taxes

Property taxes are the main source of revenue for municipalities in Canada. In 2001, property taxes accounted for over 42% of total local revenue.¹⁰ In a report on Winnipeg’s proposed New Deal, economist Hugh Mackenzie re-phrased Winston Churchill’s famous quote about democracy: “property taxes may be the worst option except for all the others”.¹¹

⁹ Enid Slack, p. 11

¹⁰ Enid Slack, p. 12

¹¹ Riding Off in All Directions, An Examination of Winnipeg’s New Deal, by Hugh Mackenzie, a Canadian Centre for Policy Alternatives(Manitoba) publication, February 2004

Property taxes are levied on residential, commercial and industrial properties and the base of the property tax is the assessed value of real property. How is value assessed in most communities? It is the estimate of the “market value” of the property – “the price that would be struck between a willing buyer and a willing seller in an arms length transaction”.¹² There may be one rate or a series of rates by type of property and the rate is applied to the assessed value of property to determine the amount of taxes payable. Property taxes are used for the following:

- municipal operating expenditures;
- to finance debt costs arising from previous capital expenditures;
- to finance future capital projects (whereby a portion of the taxes is placed in reserves for future capital expenditures – “reserve funds”).

Many argue that property taxes are imperfect. They are often not based on ability to pay, so do not necessarily represent progressive taxation. In many cases taxpayers are house-rich and cash-poor, whether they be young families or seniors on fixed incomes, and pay a disproportionate share of property taxes. However, there is in fact a rough correlation between wealth and property value - and hence ability to pay. Most provinces have introduced property tax relief schemes to relieve the burden on low-income residents. Despite their problems, property taxes are effective because they are stable - real property is immovable, unable to shift location in response to the tax and therefore easy to collect. However, while there has traditionally been a direct connection between the types of services funded at the local level and the benefits received by property owners, this has become less and less true in recent years as new responsibilities have been downloaded onto local government by federal and provincial governments.

The public distaste for property tax increases has been manipulated in Canada and is not easy to counter. The problem is, firstly, that property taxes are an easy target; they are a very visible tax because taxpayers are required to pay them directly to local governments in a lump sum or in installments (unlike income tax which is withheld at the source).

Secondly, they do not grow at the same pace as the economy.¹³ So, to increase tax revenues, municipalities often have to increase the tax rate, a politically difficult act. Income and sales tax revenues increase automatically as the economy grows, even without any increase in the tax rate.

In general, property taxes are not as appropriate for financing infrastructure with a long expected life, but more appropriate for operating demands like fire, police, parks, and other property-related services.

¹² Enid Slack, p. 12

¹³ Hugh Mackenzie, P. 3

b) Special Assessments

Special assessments (and local improvement charges, also sometimes called “development cost charges”) are made on commercial and industrial properties to pay for additions or improvements to existing capital facilities that border on those properties. The base for these assessments is usually frontage. These have been used widely by municipalities in Canada to finance capital expenditure such as paving or repaving of streets, installation or replacement of water-mains and sewers, construction of sidewalks, and street lighting. It seems appropriate for developers to pay such charges, given the burden their developments often place on municipalities for services.

c) User Fees

In 2001, user fees accounted for approximately 23% of local government revenues in Canada. They are traditionally derived from parking fees or used to pay for water and transit but are increasingly being used for recreation and other services too. Some say user fees ensure that citizens value what the public sector supplies at a marginal cost. However, although budgetary pressures have obviously pushed many communities into charging user fees, there are accessibility issues for many citizens. From additional fees for recreation programs in public facilities in many communities, to user fees in the area of water consumption or electricity, it is working people who pay an inordinate proportion of such fees.

Water metering, for example, has become a huge area of debate. The Quebec water watch group Eau Secours, insists that because social inequality is structural, one cannot make things equal through user fees like water metering. In their view, citizens understand that they are not the ones who take the most water. Most affected are those who do not have the big cars to wash, the huge gardens to water, or three bathrooms, including a Jacuzzi. Eau Secours believes that, although it's not a perfect solution, a special tax for water should be included within property taxes – because the bigger the house, the more water its inhabitants are using in most cases.¹⁴

There is a strongly subjective and political element to the application of user fees. For example, most Canadian governments have made the decision to socialize the provision of roads and highways and hence do not generally charge tolls or fees for access to roads. On the other hand, it is widely accepted that fares should be charged for public transit. This practice belies the importance most political leaders claim to attach to public transit.

¹⁴ Notes from a conversation with Andre Bouthillier, President of “Eau Secours”, a Montreal based group working on water issues.

d) “Green Taxes” or Consumption Taxes

Taxes which are linked to environmental issues in some way are called “green taxes” – taxing “bads” not “goods”. They are designed to serve two purposes. They both raise money and at the same time, in theory, they change the behaviour of taxpayers for their benefit (e.g. a tax on garbage bags may lead to people recycling more and the fuel tax may lead to people taking transit instead of using cars). However, low-income families are inevitably hit hardest. For example, a low income family driving an older model car would feel the effects of the fuel tax and would not have the same ability to trade up for a more fuel efficient model. A high-income family, on the other hand, would pay more gas tax, but may simply decide it is worth it.¹⁵

Consumption taxes are essentially regressive taxes – they are not based on ability to pay. Low-income families may spend less money but they spend a higher proportion of their income on these taxes. CUPE cannot support this method of taxation, because the union supports progressive rather than regressive taxation. This means taxation based on the ability to pay.

However, imposing ecological or “green taxes” have been effective in some European countries. David Suzuki documents how “ecological tax shifting” has been used to address climate change through carbon taxes in Denmark, Norway, Sweden, Switzerland, the United Kingdom and the Netherlands. Norway, for example has reduced greenhouse gas emissions from some industrial sectors by more than 20%.¹⁶

e) Other Taxes

Municipalities also utilize a variety of other tax sources, such as hotel room taxes. The federal government has recently promised to remit G.S.T. to municipalities, which is a positive step that should be extended to other local government entities such as school boards and public hospitals. Canadian municipalities continue to patiently await fulfillment of promises that a portion of the federal fuel tax will be provided too.

f) Federal and Provincial Grants

Grants from federal and provincial governments are another source of revenue for cities to pay for municipal infrastructure. In 2001, about 17% of local government revenues came from transfers from senior levels of government.

Cities and communities depend on provincial governments for the bulk of grants. There are both conditional grants and unconditional grants. Conditional grants usually have to be spent on specific categories. Unconditional grants can be spent on any expenditure category or they can be used to reduce property taxes.

¹⁵ Hugh Mackenzie, *Ibid*, p.4

¹⁶ David Suzuki Foundation, p. 38

Manitoba is the only province in which a set percentage of income tax revenues are passed on to municipalities. In Manitoba, two percentage points of personal provincial income tax and one percentage point of provincial corporate income tax is provided to municipalities. This is a very progressive policy which should be emulated elsewhere.

Federal grants come under the Infrastructure Canada program. In 2000 the federal government continued its support for infrastructure, but through a new vehicle, committing \$2.65 billion over 6 years for clean air and water, transportation, and affordable housing. The program requires financial contributions from both provincial and local governments. Different variants of this kind of tri-partite funding system have been in place right through the 1990s.

The first priority for the current program includes water systems, sewage treatment plants, water metering equipment and retrofitting buildings for energy and efficiency purposes. The second includes investment in community infrastructure, such as cultural and recreational facilities, infrastructure supporting tourism, local transportation, high-speed internet access for public institutions, rural and remote telecommunications, and affordable housing.¹⁷ In the February 2004 Throne Speech, the current Liberal government announced an acceleration plan for this program as part of their New Deal for cities. ("The government will move to quickly commit funds within the existing infrastructure programs").¹⁸

However, there is a major problem with these infrastructure programs at present. CUPE and several municipalities are opposed to the language which exists in each of the federal-provincial agreements except that with Quebec. This language prohibits municipalities from using their own employees to deliver federally funded infrastructure because ineligible costs under this program include:

- “(a) services or works normally provided by an Applicant or any other agency of an Applicant to implement a Project;
- (b) the salaries and other employment benefits of any employees, overhead costs as well as other direct or indirect operating or administrative costs of an Applicant, and more specifically these costs as related to planning, engineering, architecture supervision, management and other services provided by an Applicant’s permanent staff”.¹⁹

This stipulation limits flexibility for municipalities, and in a number of cases, leads to inefficiencies like contracting out of asphalt work in communities that have their own asphalt plants!

¹⁷ Enid Slack, p. 16

¹⁸ Speech From the Throne, February 2, 2004

¹⁹ CUPE Briefing Notes for meeting with Infrastructure Canada, February 2004

The Green Municipal Investment Fund is a \$200 million fund and exists alongside a Green Municipal Enabling Fund of \$50 million both designed to support the implementation of innovative environmental projects. The focus is on energy and energy services, water, solid waste management, sustainable transportation and integrated community projects.

Grant funding is not a very stable or predictable revenue source for municipalities. When the grants disappear, they are left having to make up the difference by resorting to increasing property taxes, user fees, or other revenues. Often too, conditional transfers require municipalities to spend their grants according to provincial or federal guidelines, which means decisions are made and funds are spent on projects which may or may not be a priority for that community.

g) Development Charges

These charges usually consist of a one-time levy on developers to finance the growth-related capital costs involved in new development, or redevelopment. At present, municipalities in British Columbia, Alberta, Ontario, Quebec and the Northwest Territories levy development charges.²⁰ Development charges are an effective way of taking revenue back from developers in exchange for the services they require from the municipalities.

h) Borrowing

Public borrowing remains one of the most fiscally responsible and socially responsible policy options available to governments. Governments can borrow money at cheaper rates than corporations and developers. Municipalities, unlike federal and provincial governments, can only borrow to make capital expenditures and not to meet operational requirements. Provincial rules dictate that municipalities cannot run a deficit in their operating budgets and they are limited in terms of how much they can borrow while waiting for tax revenues to be collected.²¹

However, borrowing for capital investments allows municipalities to plan for the future. If one builds a project today and the project is being paid for over the next 25 years, through repayment of principal and interest, the costs and benefits are spread over those 25 years. Those who benefit from the facility are the present users as well as those using it over the next 25 years. Everyone pays the costs through property taxes, water and sewer bills and possibly user fees.²²

²⁰ Enid Slack, p.18

²¹ Enid Slack, p. 20

²² Enid Slack, p.20

Current revenues (property taxes and user fees) do not usually provide enough money to fund large investments on a “pay-as-you-go” basis (i.e. without borrowing). The pattern of capital expenditures is usually “lumpy” - and a municipality might need millions of dollars one year to finance an infrastructure project and then the need declines for a few years. That is why borrowing is necessary, but municipalities are sometimes hesitant because potential revenues are dedicated to debt repayment instead of being available for other immediate uses.

In order for Canada to make tackle its infrastructure deficit in a meaningful way, it is clear that Canadian municipalities are in urgent need of new, reliable and progressive sources of revenue. Unfortunately, in the absence of such new revenue, there is increasing pressure to privatize public assets.

PUBLIC PRIVATE PARTNERSHIPS (P3S) – A FORM OF PRIVATIZATION

Increasingly, municipal staff and elected leaders across the country are hearing a consistent ideological message – private financing and operation of public infrastructure is necessary and “partnerships” are the way to go. The current push towards public-private partnerships (PPPs or P3s) is pervasive.

P3s are ventures where the private sector delivers public services. These P3s may involve private sector involvement in financing, designing, building, operating and owning public services, facilities and infrastructure.

P3s are a form of privatization. In the past, corporations have often designed and constructed public infrastructure including roads, bridges, schools and hospitals and will continue to do so. What then is the difference?

With most P3s the private sector lends money to build a project and the public sector leases it back by providing regular payments for the life of the contract. These long-term schemes are a troubling form of privatization. Instead of operations and maintenance contracts for two to three years, corporations or consortia establish very long-term contracts (10 – 40 years) that include the financing, leasing and ownership of public services and infrastructure.

Unlike design and build contracts, P3s threaten public control over vital public services such as health care, education, water and electricity, through allowing the private sector to determine the quality and quantity of service delivery and in some cases the cost to the user of the service. It is this shift of control from the public to the private sector that qualifies P3s as a form of privatization.

There are strong forces driving privatization within the current federal Liberal government. As soon as he took over the reins of government, Paul Martin appointed a Parliamentary Secretary to promote P3s, John McKay, who has been making bold statements about privatizing much of what is now in the public realm. The federal government has also been promoting and supporting the Canadian Council for Public – Private Partnerships (CCPPP) for the past several years. Federal infrastructure programs are supporting P3s and the contracting out of new municipal services by tying federal money to private sector involvement.

P3s are also increasingly at threat at the provincial level. For example, the provincial Liberal government of B.C. is pushing for P3s in all areas of public service and has set up a government agency called “Partnerships B.C.”. The majority of infrastructure development in B.C. is being turned over to this new entity and its mandate is to seek out further privatization opportunities. The Ontario Liberal government has broken its election promise to abandon P3 hospitals and is actively looking to P3s for a wide range of other services. The Conservative government of Alberta has pledged to expand P3s radically and several other provinces, including New Brunswick and more recently, Quebec, have declared their keen willingness to privatize public services.

Balanced budget legislation has created self-induced financing pressures on governments. Some governments claim to enter into P3s in order to keep debt off the books, but, increasingly P3 financing is being revealed as a form of debt by many provincial Auditor-Generals (for example, with regard to the Fredericton to Moncton toll highway P3, the Auditor General of New Brunswick said: “...the Province’s commitment to make lease payments over a thirty year period is not substantially different from a commitment to make debt payments to bondholders for thirty years.” And, with regard to P3 schools the Auditor General of Nova Scotia said: “...the entire cost of assets acquired under capital leases will still need to be reflected in the Province’s net direct debt.”)²³

²³ Report of the Auditor General of New Brunswick, 1998. page 178 and “Education – Public Private Partnerships (P3s) for School Construction – Follow Up Review” by the Auditor General of Nova Scotia, 1999. page 65.

There are Major Problems with P3 Financing

1. P3s increase costs. It costs the private sector more to finance construction. Generally, governments can borrow at lower rates of interest than the private sector and governments do have the ability to directly finance infrastructure.
2. P3s hide but do not reduce public debt. They are not a neutral financing mechanism – private financing is debt financing. It is a source of borrowing which has to be repaid – either out of the public purse or by giving the private sector a chance to raise user fees through, for example, toll roads.
3. Corporations have to make a profit for their shareholders and this results in higher costs for the public.

There are Many Problems with P3 Operations as Well

1. Public service expertise is often needed, but missing when a P3 is used. When the Ontario Tory government partnered with Accenture (then Andersen Consulting) in 1997 for a revised welfare system, the corporation needed and used the expertise of the Ministry of Community and Social Services employees (but paid them as government employees while Accenture “consultants” were being paid up to \$180 per hour).²⁴ The administration of social assistance is unique and requires the expertise of public servants committed to a system suited to the needs of individuals and society.
2. P3s invariably result in reduced quality of service. Reduction in staff means reduction in service. For example, when Hamilton-Wentworth Regional Government contracted with Phillips Utility Municipal Corporation (PUMC) in 1994, the workforce was cut in half within a few years. Maintenance and service began to decline and in 1996, 180 million litres of untreated sewage spilled into Hamilton Harbour. In the U.S. where privatization of cleaning and housekeeping services in health care is more widespread than in Canada, cuts in cleaning and infection control standards contributed to 103,000 patient deaths in 2000.²⁵

Five years after one of the Halifax P3 schools was built, children are still drinking bottled water after arsenic was discovered in the school’s well-water.

3. High turnover is common with P3s. Because private sector support services pay lower wages than public sector support services, private sector employees are more likely to leave their jobs. High turnover in turn reduces quality of service.

²⁴ “Private Means to Public Ends: The Future of P3s”, by Finn Poschmann, C.D. Howe Institute, June 2003

²⁵ “Infection epidemic carves deadly path: Poor hygiene, overwhelmed workers contribute to thousands of deaths”, by M.J. Berens, Chicago Tribune. July 21, 2000

4. Reduced wages are the norm in P3 operations. Private contractors usually pay their workers much less than public employers. This has a negative effect on the whole community.

Problems with P3 Accountability

1. Reduced transparency. P3s privatize information that should be kept clearly within the public realm. This is a major problem as the public is often denied access to vital information on the grounds of commercial confidentiality.
2. Reduced public control. When private managers take over, the aim is to cut costs, even at the expense of services. In Nova Scotia, Learning Centres decided where schools should be located with some devastating results for the community, including arsenic in the water in one school. Public control of public resources is essential.

Public-private partnerships are being promoted across Canada, in the U.S. and in many other countries – despite having an “atrocious history” according to economist John Loxley. Auditors-General are consistently raising concerns with P3s in both Canada and abroad. In recent reports, even organizations such as the World Bank and more locally, the C.D. Howe Institute, while supporting the principle of P3s, cannot point to any outright successes in terms of public benefit.

A recent Ipsos-Reid poll shows that an overwhelming majority (84%) of Canadians want their public services delivered by public sector workers accountable to elected representatives and the public, rather than by corporations accountable to their shareholders. The polling shows that women in particular are more likely to oppose privatization. It is women who are hit hardest when services are privatized. Women are the ones most likely to lose their jobs through privatization as stable public sector jobs that pay enough to support a family are replaced by low-wage, part-time work with private contractors. As well, they suffer service cuts and fee hikes and are often expected to fill the void at home and in the community.

Canadians in general are skeptical of P3s. When asked whether Canada should rebuild its public infrastructure – hospitals, schools, highways and water systems – through direct public investment or through P3s, 75 per cent say keep it public. Whether we look at the sorry history of P3 schools in Nova Scotia, Highway 407 in Ontario or looming P3 hospitals across the country, we see the politicians ducking their responsibility, the corporations reaping windfall profits and the public left holding the bag. Canadians don't want this. Instead what they are calling for is direct public investment – the cheapest and most responsible way to rebuild strong public services, which in turn are the cornerstone to strong communities.²⁶

²⁶ Ipsos-Reid Poll, March 2004

The Case Against P3s and for Public Borrowing

Auditors Generals of Ontario, Nova Scotia and New Brunswick, and the National Audit Office in the U.K. have expressed concerns with specific P3s. In particular, they are concerned about the comparisons that are used to justify the choices of P3s as cheaper alternatives to public ownership. In New Brunswick,, the Evergreen Park school in Moncton, was leased by the government from a private company, Greenarm corporation of Fredericton. The Auditor General reported that the province could have built the building at a lower cost than Greenarm. The Province also transferred land at less than market value once the lease costs are allowed for. The cost of private borrowing at 9.065% was well in excess of the Province's costs of 8.787 %, raising effective capital costs again. The Province estimated present value savings of \$185,000, whereas the Auditor General estimated additional present value costs of \$900,000.²⁷

Lewis Auerbach who formerly served as Director in the Audit Operations Branch of the Auditor General of Canada has addressed the problems this way.

“Governments can decide not to make funds available, or to make them available for some kinds of projects and not for others. In other words, the constraints that lead to the choices are self-imposed. It is a choice especially difficult to comprehend when it leads to higher, rather than lower cost to taxpayers”.²⁸

In February 2004, the Toronto Health Coalition submission to the Ontario Budget Consultations, prepared by economist Armine Yalnyzian, of the Canadian Centre for Policy Alternatives (CCPA), clearly presented the case against private financing.

“The first rule of thumb is that the cheapest source of finance is through public borrowing. The implicit political rule that goes along with this is that taxpayers should not be paying more to developers for their efforts to raise capital when governments can do it more easily and definitely at lower cost”.²⁹

²⁷ CUPE research on Evergreen Park School P3

²⁸ Issues Raised by Public Private Partnerships in Ontario's Hospital Sector, by Lewis Auerbach, written for CUPE, 2002

²⁹ Toronto Health Coalition Submission to the Ontario Pre-Budget Consultations, February 11, 2004

The Toronto Health Coalition submission used the example of the William Osler Hospital to demonstrate the difference between public and private borrowing:

“It is estimated that the cost of building the hospital is about \$1 billion. The Ontario Hospital Association estimates that the capital needs of the hospital sector currently sit at between \$7 and \$9 billion.

A government floats bonds for its major capital needs. The current 21-year yield-rate of an Ontario bond is about 5.56% a year.

A private investor would want to get a premium for raising the money for the government from the capital market. I have assumed they will not get much more than $\frac{1}{4}$ of a percentage point on top of the government long-term rate as a “risk premium”, because the government will implicitly or explicitly guarantee the loan, as it must in such a sensitive area of public policy...

However, the public sector borrows all the money it needs. The private sector puts down some amount of equity in order to borrow.

Whereas typically the equity (like a down-payment to get a mortgage) would range between 15-20% of borrowing needs, I am assuming a much lower equity rate of 10% down. However the private financier would need a higher rate of return on his/her equity than $\frac{1}{4}$ of a percentage point. Typically P3s yield between 15-20% rates of return on equity, in North America and in the UK. Again I am assuming this government will bargain for a better deal for Ontario’s taxpayers, and limit the returns to 10% per annum on this equity.

So far we have been talking about P3s in a way that separates borrowing and revenue. But you have a revenue problem, so we need to talk about the connection between borrowing and taxes. The attached table lays out the links”.

THE DIFFERENCE BETWEEN PUBLIC AND P3 BORROWING						
	Ontario Government Borrows @ 5.5%	Private Sector Borrows 90% @ 5.75%	Private Sector Puts up 10% Equity Capital at 10%	Average Cost of Private Sector Deal	Additional Costs of Private Financing over Public Financing	
Costs Per Year to Borrow (New Taxes or Reduced Spending on Other Program Areas)						
\$1 Billion	\$55,000,000	\$51,750,000	\$10,000,000	\$61,750,000	\$6,750,000	
\$7 Billion	\$385,000,000	\$362,250,000	\$70,000,000	\$432,250,000	\$47,250,000	
\$9 Billion	\$495,000,000	\$465,750,000	\$90,000,000	\$555,750,000	\$60,750,000	
Borrowing Costs over 30 Years						
\$1 Billion	\$1,650,000,000	\$1,552,500,000	\$300,000,000	\$1,852,500,000	\$202,500,000	
\$7 Billion	\$11,550,000,000	\$10,867,500,000	\$2,100,000,000	\$12,967,500,000	\$1,417,500,000	
\$9 Billion	\$14,850,000,000	\$13,972,500,000	\$2,700,000,000	\$16,672,500,000	\$1,822,500,000	
What could you do with the difference between P3 and public financing?						
Average cost of 1 registered nurse: \$60,000 - \$7 million could buy 117 nurses a year.						
Average cost of 1 four-year nursing program: \$35,000 - \$28 million could buy 800 new nurses in four years.						
* based on 2004 CCRA preliminary estimates of number of Ontario taxpayers in 2002 tax year = 5,783,120						

To use P3 financing on just one billion dollar project would therefore cost Ontario taxpayers almost \$7 million a year over and above what they would be paying in new borrowing costs if the government provided the financing. The Toronto Health Coalition estimates that if all emerging capital needs (for expanding facilities and upgrading them) in Ontario were financed using P3s, the additional annual costs for Ontario taxpayers would range between \$47.2 million and \$60.8 million a year.

The Ontario Hospital Association has identified a list of needed future hospitals. If P3 financing is used for these new Ontario hospitals, the total unnecessary expense to Ontario's taxpayers, over the life of these agreements (up to 30 years) would range from over \$200 million just to finance one billion-dollar project, to between \$1.4 and \$1.8 billion for the province as a whole.³⁰

Public borrowing, therefore, is clearly a far more fiscally and socially responsible choice.

³⁰ Toronto Health Coalition Submission, p. 5, 6

HOW HAVE PENSION FUNDS BEEN USED TO FINANCE PUBLIC INFRASTRUCTURE?

Currently, nearly every major P3 has some sort of pension plan partner, including many CUPE member plans, for example the Ontario Municipal Employees Retirement System (OMERS).

OMERS is not a joint trustee plan. In 1998, OMERS created a subsidiary company, Borealis, for the prime purpose of investing in P3s. Until February of 2004, the Canada Pension Plan Investment Board was also a joint owner of Borealis. OMERS has recently taken back sole ownership and direct control of Borealis. However, this share buy-back deal between OMERS and Borealis cost the pension fund nearly \$100 million in the past 12 months. The cost included \$46 million in asset-management fees paid to the firm last year. In February 2004, OMERS also paid \$49.9 million to buy out other Borealis share-holders (including \$15 million for three Borealis managers!) in order to bring the operations of the company back under the pension fund's direct control.

Borealis (now OMERS directly) is providing the financing for both of the planned Ontario hospital P3s - the William Osler Hospital in Brampton and the Royal Ottawa Hospital. It was also one of the four consortia originally short-listed for the Abbotsford hospital P3 and provided financing for the Nova Scotia P3 schools. It is very disturbing to see CUPE members' pension contributions invested in the privatization of healthcare and education.

Canada Pension Plan (CPP)

Until 1998 all CPP surplus funds were invested in provincial government bonds, the provinces were able to borrow at federal government rates – lower than borrowing through the direct market. In this way, much of the public infrastructure in Canada was built with the help of capital invested by the CPP.³¹

Although since the mid-1980s the market value of pension fund assets has increased by almost 600% (to reach almost \$600 billion in 2000), governments have become more ever more conservative when it comes to investments by pension funds.

A return to public financing for public infrastructure will be more cost effective than the current strategy.

Pension funds must start to channel their infrastructure investments through public investment vehicles.³²

³¹ Globe and Mail, May 13, 2004

³² The Role of Pension Funds in Financing Investment in Public Infrastructure, written for CUPE by Monica Townson, October 2003, P. 9

Pension fund capital is in a strong position today. The top 100 pension funds in Canada in 2003 were worth about \$475 billion.³³ The CPP holds assets of approximately \$56 billion and the value of these are expected to rise to \$80 billion by 2007 and \$160 billion by 2013.³⁴

Many of the larger funds are looking for investment opportunities in all kinds of areas, including shopping centres, hockey, real estate and foreign securities (limited to 30% of the book value of the fund portfolio). Most pension plan members in Canada are public sector workers and some of the largest pension funds are public sector funds. These public sector funds have hundreds of billions of dollars available to invest.^{35 36}

The asset mix held by these pension funds varies from year to year. However, about one-third of their total assets are invested in Canadian bonds. In 1990, public sector pension funds invested just over 52% of their assets in bonds (compared with 36% for private sector funds). By 2000, public and private sector funds held only 26.5% of their assets in bonds. Public sector funds have now become much more like the private sector funds in the way they allocate their assets to different types of investments.

The Canada Pension Plan Investment Fund

The 1996/97 review of the CPP has had consequences for how investment funds from the CPP may or may not be used in the future as a source of funding for public infrastructure. In January 1998, federal and provincial finance ministers, who administer the plan, decided to raise contribution rates significantly over a six-year period. The goal was to reach a combined employer-employee rate of 9.9% of contributory earnings (compared with a combined rate of 5.6% in 1996). The objective was to generate surplus funds (equivalent to five years worth of benefits) and to establish a CPP investment board to invest these funds in the capital market. Starting in 2004 the investment board will be responsible for long-term bonds and cash portions of the CPP portfolio as well as investing contribution revenue not immediately needed to pay current benefits. In March, 2003, the fixed income securities were about 69% of total assets, of which \$31 billion was invested in federal and provincial government bonds and \$7.1 billion in interest-bearing cash deposits.³⁷

³³ Monica Townson, p. 19

³⁴ Jim MacDonald, quoted in Monica Townson, p. 18

³⁵ Canada Pension Plan Investment Board, 2003

³⁶ Pension funds with assets of \$10 billion or more include: the Ontario Teachers' Pension Plan Board, with market value assets of \$65 billion; the Quebec Government and Public Employees Retirement Plan, with \$49.4 billion; Ontario Municipal Employees Retirement System (OMERS) with \$29.5 billion; Hospitals of Ontario Pension Plan (HOOPP) with \$16 billion and the B.C. Municipal Pension Fund with \$14.5 billion; the Teachers' Superannuation Plan (RRE, Quebec) with \$12.9 billion; the Ontario Pension Board with \$11.5 billion; the B.C. Public Service Pension Fund with \$11.4 billion; the Canadian National Railways with \$11.1 billion; the BCE Master Trust Fund with \$10.6 billion; and the B.C. Teachers Pension Fund with \$10.2 billion. (The Quebec figures include government debt which appears in Quebec's public accounts in accordance with the plan's presentation basis)

³⁷ Monica Townson, p. 19

Now, however, the CPP Investment Board is suggesting that, “government bonds do not produce the level of real returns required by the Canada Pension Plan. To achieve higher returns than bonds, we must acquire assets that have greater risk”.³⁸

In the 1997 – 1998 report of the CPP, the government predicted that the new investment policy could secure an average long-run rate of return of 3.8% above the rate of inflation compared with 2.5% if the old policy remained intact. However, the fund has been earning high rates of return on long-term provincial government bonds because they were purchased in the early 1980s when interest rates were high. Their weighted average rate of return is 11.36%.³⁹

Although the board says that bonds will continue to form an important part of CPP assets for the foreseeable future, it also intends to expand its real return assets to include infrastructure (“pipelines, electrical utilities, roads, bridges, schools and hospitals”).⁴⁰ The CPP Investment Board has, in the recent past been a part owner with OMERS of Borealis which leads us to believe that their future infrastructure investments will involve public private partnerships.

A recent report in Public Works Financing (the “International Business Guide to P3s in Infrastructure Finance”) cited a new CPP investment (\$100 million) into the Macquarie Essential Assets Partnership, the “first infrastructure investment for the Cdn \$64.4 billion fund”.⁴¹

At a World Bank conference in 2003, John McNaughton, President and CEO of the CPP Investment Board, said:

“We are not a captive source of credit for governments. We do not have to buy government debt unless we decide to build a bond portfolio. And even then only if the terms are attractive and in keeping with our legislated and fiduciary duties. We are not required to make loans to state-owned firms. Nor do we have social investment requirements. In short, we do not invest according to any public policy objective other than to keep the public pension promise. This alone is a worthy social objective that deserves a focused investment mandate undiluted or distracted by other public policy goals and social causes”.⁴²

He also emphasized that “governments have no say on our asset mix policy. Nor do they choose to”.

³⁸ Monica Townson, p. 24

³⁹ Canada Pension Plan Investment Board, 2003

⁴⁰ Monica Townson, p. 25

⁴¹ Canada Pension Plan Investment Board, 2003

⁴² Public Works Financing, January 2004

Targeted Investments for Infrastructure Funding

Pension funds can play a positive role in helping to finance public infrastructure if properly used. They can provide a good rate of return for pension plan members and at the same time assure governments of capital at a reasonable rate. But it is generally considered the fiduciary duty of pension trustees to achieve the best possible return for the fund in order to be able to pay all the promised benefits. Are these two objectives compatible in this new environment? Can pension funds target their investments to achieve a particular social or economic objective?

In 1984, union trustees for the British coal miners' pension fund insisted that the fund not invest in energy industries in direct competition with coal. The Court of Queen's Bench ruled against the union trustees. However, in the case of the New York City teachers plan, the court found that investing at less than the going return on investments in the market is acceptable if it protects the members' interests in maintaining a job up until retirement.⁴³

Some believe that the British coalminers' case (the Scargill case) has played too large a role in influencing other pension trustees in Britain and Canada and that the maximum rate of return is not a standard for all plans (e.g. the Ontario Public Service Employees' Union Pension Trust has an investment policy to achieve "reasonable rates of return".⁴⁴

In 2000, an index was created by Michael Jantzi Research Associates in Toronto, to measure the stock market performance of sixty Canadian companies that pass a broadly-based set of social and environmental screens. Since it was created, it has generally out-performed the TSE 300 index.⁴⁵

How Can Plan Members Influence Investment Decisions?

There is growing public awareness that pensions are deferred wages and that pension funds belong to the workers who are members of the pension plans. But how much control do members have over these funds? Generally, pensions trustees and their investment advisers have a great deal of autonomy from plan beneficiaries, unless there is joint trusteeship, with unions being equally represented on the board of trustees. Joint trusteeship is a necessary and important reform for most pension plans. In the public sector, governments need to make joint trusteeship a priority.⁴⁶

CUPE has achieved joint trusteeship in a growing number of plans. The Hospital Employees' Pension Plan (HEPP), the Hospitals of Ontario Pension Plan (HOOPP), the British Columbia Municipal Workers' Plan, The City of Winnipeg Municipal Employees Plan, the CUPE Hospital Workers Jointly Trusteed Plan, the New Brunswick Nursing

⁴³ John McNaughton Quoted in Monica Townson, p. 25

⁴⁴ Monica Townson, p. 28

⁴⁵ Isla Carmichael and Jack Quarter, editors Money on the Line: Workers Capital in Canada, 2003, p. 61

⁴⁶ Monica Townson, p. 28

Home Workers' Plan, and the Saskatchewan Hospital Employees' Plan (SHEPP). CUPE is the sole union trustee for two plans, the Nursing Homes and Related Industries Pension Plan (NHRIPP) and the Multi-Sector Pension Plan (MSPP).

Examples of Targeted Infrastructure Funding

Some unions in the private sector have been able to influence investment decisions through collective bargaining. In 1993, the CAW in its negotiations with Chrysler Canada, obtained an agreement on an over \$2 million pension asset allocation to co-operative and non-profit housing development in Ontario, subject to government fiscal partnership.

In 1965, the AFL-CIO Housing Investment Trust was established with unions pooling their funds and designating pension fund assets for investment in affordable housing stock and at the same time their aim was to create jobs for union members in the building trades. This trust uses union contractors exclusively and has funded hundreds of affordable housing projects and other real estate projects.

In 1980 in British Columbia., Concert Properties (formerly Greystone Properties Limited), was formed when 26 jointly-trusted private sector union pension funds pooled a small portion of their funds and formed a real estate development company to provide rental housing. Although it is unfortunate that Concert Properties has supported P3s it uses only union labour and is now the largest developer of rental housing in western Canada.⁴⁷

How to Encourage Funding of Public Infrastructure by Pension Funds

Although it is difficult to counter the current ideological trend towards private market solutions, pension funds need to be encouraged to invest in public infrastructure.

Working in our favour are reports such as the World Bank report on private participation in infrastructure in developing countries, which clearly documents the failure of the experiment in privatization in many developing countries.⁴⁸ The British government's venture into privatization of public infrastructure has seen disastrous results for health care, water, electricity and railways. The All-Party House of Commons Transport Committee in the U.K. recently condemned the results of privatization. Members of Parliament recommended re-building a new public rail agency. Unfortunately, we need to learn from the negative, real world results of privatization to inform a range of positive alternatives. And, according to Managing Director Dr. Anne Krueger, the International Monetary Fund will shortly issue a report calling on the British government to include

⁴⁷ Unions and Pension Investments, a paper presented by Bob Baldwin at a Canadian Labour Congress conference on Jobs and the Economy, Ottawa, February, 1998

⁴⁸ Monica Townson, p. 32

some 100 billion pounds in hidden P3 borrowing within open public accounts
Privatization is not at all inevitable.

POSSIBLE ALTERNATIVES FOR FUNDING INFRASTRUCTURE

In contrast to the numerous problems that follow privatization of infrastructure financing, there are many good, progressive alternatives available for funding of Canadian infrastructure. In choosing infrastructure alternatives, policy makers should bear principles such as democratic control, public ownership and ability to pay in mind. Some good options include:

a) Pooling of Municipal Debt

Municipal financing authorities should be established in provinces in which they do not currently exist.

As the cost of borrowing is high for individual municipalities, especially smaller municipalities, pooling of municipal debt is one way to lower costs of borrowing. Local governments can issue bonds. These bonds are purchased by a bond bank – usually an independent authority established by provincial statute. The bank then pools the issues and sells the larger, combined issue on the national bond market at a lower cost than can some individual municipalities.⁴⁹

There are municipal financing authorities established in most provinces. These include:

- The Municipal Financing Authority in B.C.
- The Municipal Capital Borrowing Authority Board, N.B.
- Municipal Finance Corporation in N.S.
- The Newfoundland Municipal Financing Corporation
- The Ontario Municipal Economic Infrastructure Financing Authority (OMEIFA)

In some cases, larger cities (like Winnipeg, Regina, Saskatoon, Edmonton, Calgary and Vancouver) issue their own debt rather than using the provincial agencies.

Municipal finance authorities issue bonds for municipal units as well as for schools, hospitals, utilities and other municipal bodies. Usually loans are directly guaranteed by the provincial governments and administration costs are picked up by the provincial government. (They can sometimes be covered from earnings on reserve funds, by participants or by a combination). The advantage to pooling local government debt issues is that borrowing costs are lowered substantially – reflecting the reduced cost of capital and also lower administration costs.

⁴⁹ Private Participation in Infrastructure in Developing Countries: Trends, Impacts and Policy Lessons, by Clive Harris, Washington, World Bank, 2003

An Ontario study looking at a hypothetical municipal finance borrowing corporation or authority (prior to the OMEIFA) concluded that it would lower costs significantly to municipalities compared to the actual cost of capital for municipal issues in Ontario. Especially for small municipal units, which are un-rated and borrow for a longer time period, this method appears to create significant savings.

b) Government Bonds

Governments ought to be issuing special bonds to fund infrastructure projects. Federal, provincial and municipal bonds are generally considered very low-risk because they are issued and guaranteed by the government. Lenders can be quite sure they will be repaid in full. However, the interest paid on government bonds is fixed for the term of the bond, so they are not the favourite of some speculators. Ironically, loans for public infrastructure may offer a lower rate of return for institutional investors than public-private partnerships, which must borrow at higher rates.

c) Real Return Bonds

A real return bond adjusts interest rates for inflation so that the return on investment will match any increases in prices over the life of the bond. Incredibly, although these should be an effective way of encouraging pension funds to invest in public infrastructure, they are not currently available in meaningful amounts, according to the CPP Investment Board. Governments in Canada are so fixated on paying down debt that they seldom use this alternative. The total amount of outstanding federal issues of real return bonds is about \$14 billion (approximately 4.5% of the total supply of Government of Canada marketable bonds currently outstanding).

Some critics say the disadvantages of real return bonds are that they do not have fixed and known payouts, their tax status is complicated and they are illiquid, but the reality is that real return bonds in Canada have performed better than many realize.⁵⁰

d) A Democratically Accountable and Dedicated Infrastructure Fund

The federal government could create a democratically accountable pool of funds to be directed at renewal of public infrastructure based on environmental principles, perhaps a Green Infrastructure Fund for pension funds. Such a fund would issue bonds, not just provide funding for green infrastructure (as the current government Green Funds are set up to do).

Governments could offer attractive interest rates and effective marketing could make them appealing to pension funds. Bonds issued by such a fund would generate other monies, which the federal government could then use to distribute to junior levels of government for investment in green infrastructure. Provincial governments could do the same. As economist Monica Townson has explained:

⁵⁰ Enid Slack, p. 21

“It could be viewed as a way of organizing the debt that is generated from public infrastructure investment and renewal, which may assist not only in attracting investment capital from public sector pension funds in particular but also in drawing attention to the positive commitments that actually are undertaken by governments that use it”.⁵¹

e) Tax-Exempt Bonds

Another idea is to initiate tax-exempt bonds offering preferential tax treatment to bond issues which are directed at funding public infrastructure. Here is how they could work:

- assuming the interest rate on bonds is 5%, a \$1000 bond yields \$50 in interest;
- if a taxpayer's marginal tax rate is 40% (federal and provincial combined), the taxes normally due for that interest revenue would be \$20, hence the after-tax interest would be \$30;
- the effective interest rate is 3%;
- so, if a municipality could issue a tax-exempt bond, it could save two basis points by paying only 3% interest through providing the same after-tax return to the investor.⁵²

For municipalities, issuing tax-exempt bonds means that they can borrow funds at a lower interest rate than regular bonds because investors are willing to receive a lower interest rate if it is not taxable.

In the U.S., tax-exempt bonds have been used by municipalities for a long time. Following September 11, 2001, New York State developed incentives to rebuild New York which included triple tax exempt bonds and taxable reconstruction bonds which could be purchased by public employee pension funds.

The new tax-exempt Ontario opportunity bonds went on sale in April 2003, but because the federal government did not agree to participate, bondholders only benefit from lower provincial taxes. The proceeds from these bonds are available for municipalities to borrow at reduced interest rates to finance local infrastructure. More than 50% of the interest costs on loans from OMEIFA to municipalities are expected to be subsidized by the provincial government. As well, the province committed more than \$1 billion as an initial capital infusion to OMEIFA plus an additional \$120 million for water and sewer projects through the Ontario Clean Water Agency.

The main drawback of tax-exempt bonds is that they are regressive because people with higher incomes benefit more than those with lower incomes from this tax incentive.

⁵¹ Monica Townson, P. 38

⁵² Enid Slack, P. 22

f) Subsidies from Senior Levels of Government

In 1993 the United States Commission to Promote Investment in America's Infrastructure recommended that the government actively overcome the pension barriers that existed. Here in Canada, we could go much further and set up some form of federal subsidy to encourage lower levels of government to issue debt instruments as a way of funding public infrastructure.⁵³

g) Crown Corporations to Channel Public Investments in Infrastructure

Canada Mortgage and Housing Corporation (CMHC) is a crown corporation, wholly owned by the federal government, which issues bond and mortgage-backed securities and uses its borrowing proceeds to provide mortgage loan financing to social housing project sponsors. Its bond issues are fully guaranteed by the federal government and in fact, offer a higher yield than Government of Canada bonds. CMHC bonds are available to individuals and institutional investors. It administered loans to municipalities in previous years for projects related to municipal water and sewage systems, neighbourhood improvements and urban renewal.

An infrastructure corporation, structured as a wholly owned crown corporation similar to CMHC, could be created by the federal government. Because investment decisions of such an entity would be so crucial, it is important that the Board of Directors be accountable to Parliament.

h) Public Interest Companies (PICs)

PICs are a new form of organization being debated and discussed by UNISON, the largest public sector union in the U.K. They are a new concept for delivering public services, as they would exist solely to provide a special public benefit. PICs would be set up to raise finance on the money market but could not pay variable dividends to shareholders (unlike public limited companies). They would be independent from government, allowing them to be entrepreneurial and responsive to their users. However, there is no existing legal form of PICs yet. The Public Benefit Corporations (the standard charity structure in the U.S.) are used for public service delivery and they have many features of the PICs.

Canadian communities reflect the inequalities, which exist in the country as a whole. The widening gap between rich and poor is threatening our social fabric. At the same time, crumbling urban infrastructure and chronic under-funding of public services means a poorer quality of life for all communities. It is past time for a new deal that improves democratic control, protects our quality of life, supports quality public services and rebuilds our cities and communities.

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⁵³ Monica Townson, P. 39