Austerity Infrastructure: financializing, offshoring, and tax sheltering public-private partnership funds

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Background

- ***Austerity is redistribution***.
- ***Austerity is not always about less***.
- ***Austerity is nothing new***.

Austerity alters who bears the brunt of revenue crises and how terms of debt repayment are arranged. Often governments pay for spending cuts by using creative accounting techniques that draw on private finance and debt markets, particularly when it comes to funding long run budget items like infrastructure and pension obligations. Sometimes reductions in one area do not reflect less spending overall but instead different types of spending with different sets of obligations and benefits associated with who gets what, when, and how. Despite bouts of state retrenchment exhibited over thirty years, we continue to see plenty of support for capital offered through tax expenditures, loopholes, tax exemptions, deductions, bailouts, joint ventures, co-financing, and public-private partnerships.

Austerity Infrastructure

Austerity implemented since the 2008 global financial crisis and the 2009-10 banking/auto sector bailouts has yet to produce the growth and wellbeing promised by its proponents. As of 2016, significant levels of new profitmaking remain largely confined to financial markets, corporations are reticent to hire and invest, interest rates are at long run historical lows, and states continue to unwind debt reduction programs initiated in 2010.

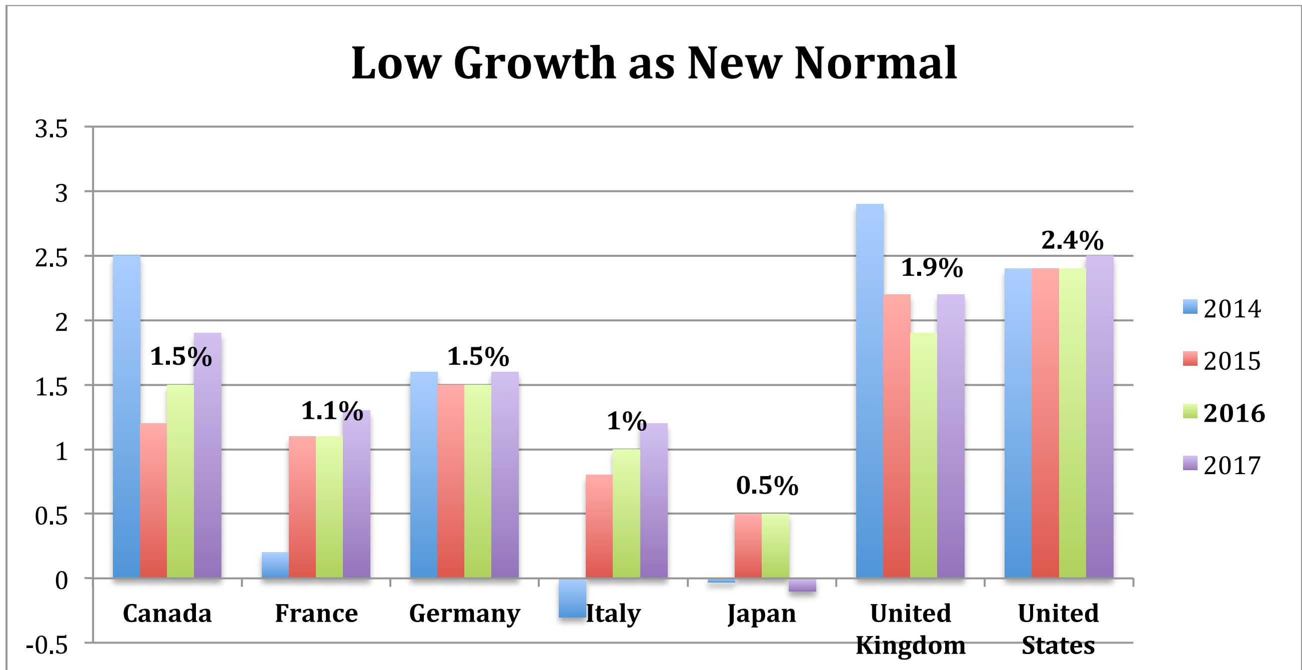
The enduring norm of austerity exists side-by-side with efforts to promote stimulus through investment in public infrastructure. For nearly four years, organizations like the OECD and IMF, national governments of the G-7, and a host of private consultants and policy promoters have been touting public works as economic saviour. In Australia the program goes by the name of 'asset recycling', in the US it is 'asset monetization', in Canada we see 'innovative' efforts aimed at creating an infrastructure bank that offers equity rights to institutional investors. While some aspects are novel, these initiatives are for the most

part an extension of the decades-old public-private partnership model used in designing, building, financing, and operating public infrastructure like highways, bridges, schools, and hospitals; it is also an extension of the longstanding neoliberal push for privatization amid fiscal restraint.

Recent and well-established currents coalesce to ***reconfigure sources of revenue and expense for public works***, namely drawing on ***private finance to pay for public infrastructure***. The promise is infrastructure-led stimulus for the public, the guarantee is infrastructure-created opportunities for private finance. But their investment in our stimulus comes at a cost: higher interest rates, higher overall costs, more revenue extracted through private partner equity rights and offshoring practices, control lost for the service user and taxpayer, and public works that sacrifice what we really need for what is commercializable. The public pays either way; all debt repayment funds can ultimately be traced back to either service users or taxpayers.

Low Growth Era Austerity & The Infrastructure Gap

The notion that cutting government debt and balancing the books will produce prosperity through 'expansionary austerity' has thus far proven illusory. Instead it appears as though low growth is the new normal. Amongst the G-7, actual and projected growth rates barely break 2 percent, most economies hover in near stagnation.



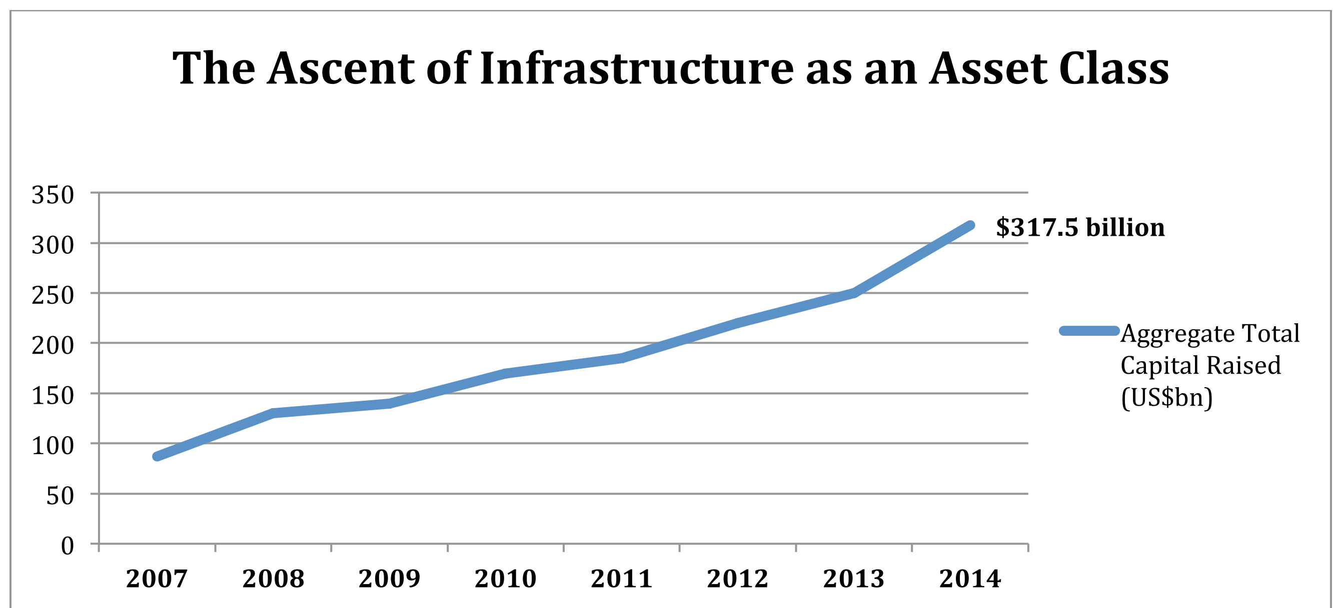
Source: IMF, *World Economic Outlook* database, April 2016.

Low growth means less government revenue but not fewer cost pressures. Three decades of neoliberal era spending restraint have left countries around the world with a public infrastructure investment crisis. By 2030, according to one prominent estimate, the

global need for infrastructure spending will total $57 trillion (McKinsey Global Institute 2013).

Aging and inadequate infrastructure compound the revenue/expenditure conundrum by cutting into productivity. Gridlock is blamed for $101 billion in excess fuel and time costs in the US and $2 billion annually in Canada's Greater Toronto Area alone (McKinsey 2013; TD Economics 2004). National policy makers are now hearing from private consultants and international organizations alike that they can 'unleash productivity through infrastructure' (e.g., Advisory Council on Economic Growth 2016).

Serendipitously, low growth economies with governments in need of infrastructure exist side-by-side with capital-awash investors looking not to build factories or expand production but to buy portfolio assets. Prime rates have been very low for a very long time – this being an era of tight fiscal policy and exhausted monetary policy. Institutional investors in particular, especially the well-capitalized pension funds that used to invest in sovereign bonds, are now turning to infrastructure for its safe, relatively high yield returns. ***The search for yield propels the ascent of infrastructure as an investment class, the creation of infrastructure funds by investment banks, and magnifies the chorus of consultants advising government that more/new infrastructure is needed to boost growth.*** Opening space for private capital investment appears now as *the* way to deliver both stimulus and portfolio guarantees in an era of low growth austerity.



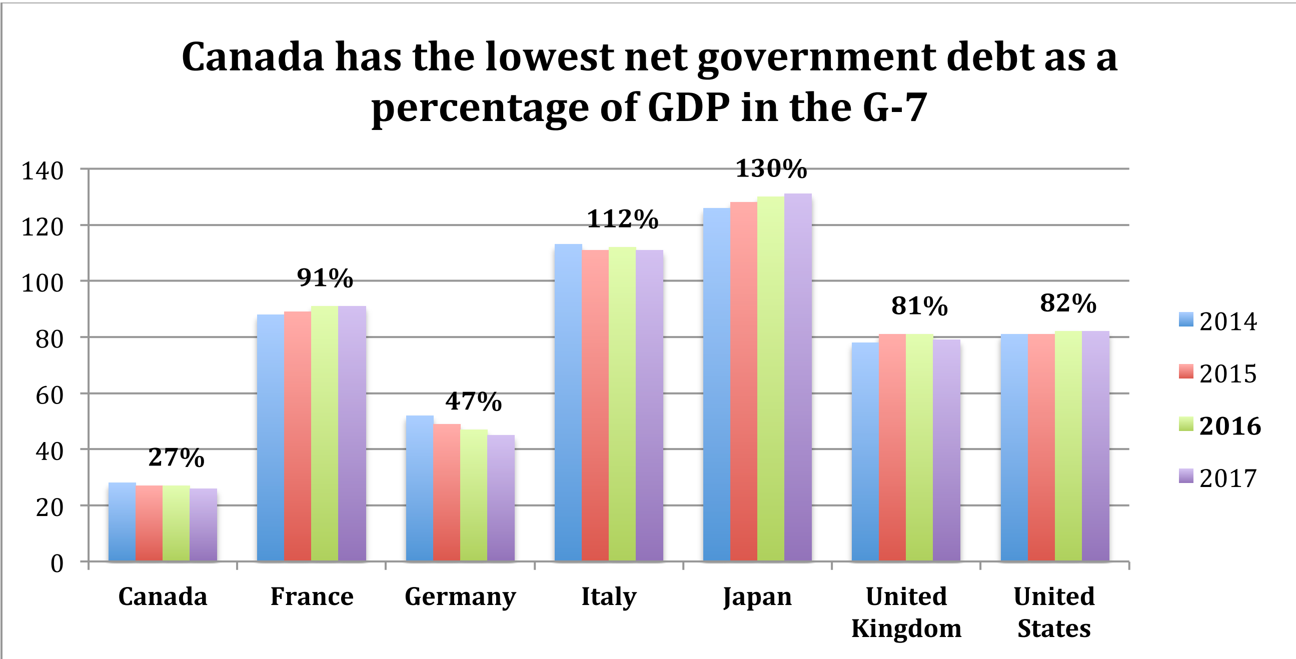
Source: BlackRock. 2015.

Canada's Austerity 'Alternative'?

In 2015 Canada elected a national Liberal government with a platform offering alternatives to austerity – promising to spend on stimulus rather than balancing the budget. During the campaign period, the Liberals made several infrastructure-related pledges. Most notably, they floated the idea of establishing an infrastructure bank as a dedicated source of funds to address the infrastructure gap.

> "We will establish the *Canadian Infrastructure Bank* to provide low-cost financing for new infrastructure projects. The federal government can use its strong credit rating and lending authority to make it easier and more affordable for municipalities to build the projects their communities need. Where a lack of capital represents a barrier to projects, the Canada Infrastructure Bank will provide loan guarantees and small capital contributions to provinces and municipalities to ensure that the projects are built."
> (Emphasis added, Liberal Platform, October 2015)

From late 2015 until November 2016, it was unclear where exactly the funds would come from to capitalize the bank. Consistent with the overall tenor of the Liberals as offering alternatives to austerity through stimulus-touting campaign rhetoric, it was entirely likely that this money would be found through 'public' sources such as issuing government bonds. Canada enjoys the lowest ratio of net debt to GDP in the G-7, and has/will for sometime, and thus sovereign debt is not a concern. ***Canada's unique low debt status makes it a test case for the sincerity of post-austerity alternative visions within mainstream politics***.



Source: IMF, *World Economic Outlook* database, April 2016.

Unfortunately, campaign rhetoric proved fickle. Rather than using public funds to finance public works on the cheap, the incipient Canada Infrastructure Bank will open its doors (and public assets) to private capital investment. Touted as a 'win-win', Canada intends to attract institutional investors' sizeable supply of capital by "identify[ing] a pipeline of potential projects and identify[ing] investment opportunities that provide the biggest economic, social and environmental returns" (Minister of Finance 2016, 7). Public infrastructure will be reconfigured: revenue-generating infrastructure projects – those 'commercializable' through tolls and user fees – will be targeted and equity investments will be offered. ***Canadians' stimulus will now come with a price tag of at least 7-9 percent return on investment for private equity holders.***

Equity Sales and Offshoring Infrastructure

Not only is the low growth, low primate rate, austerity era creating clamber for infrastructure assets as safe, high yield investments with near guaranteed returns, there is also now ***a flourishing secondary market for infrastructure equity***. Whitfield's (2016) recently released report on the topic reveals a £17.1bn industry churned up by the buying and selling of equity in public-private partnership (PPP) infrastructure project companies, with rates of return on investment coming in at upwards of 50 percent (five times the amount typically agreed to in the average PPP business case). These earnings flow to the original private partner, the secondary market investors re/selling equity in the project company, and associated shareholders. Staggering returns generated off public infrastructure could be constituted as private profiteering by any measure yet the report further highlights the increasingly offshore nature of this secondary market. ***Many associated companies are registered in tax havens meaning none of their revenue recycles in the domestic market through redistributive taxation***. Sizable profits are found here, with the five largest listed offshore infrastructure funds making a total profit of £1.8bn from 2011-2015, monies that would be of great benefit to struggling cash-strapped governments, particularly the municipalities where these infrastructure projects are located. These asset values are entirely fictitious but built on the foundation of local economic realities: communities and their hospitals, bridges, highways, and schools.

In Canada, where more than 200 PPPs have been developed, over twenty equity sales have occurred as of 2016. Given that most Canadian PPPs have only been developed in the past 5-10 years, and are typically social (not commercialized) infrastructure, this secondary market in equity sales is set to grow. Along with its growth comes revenue loss through offshoring. Already we see tax haven-registered companies buying and selling Canadian public infrastructure assets: Bilfinger Berger Global Infrastructure (registered in Luxembourg), HICL Infrastructure Company Limited (registered in Guernsey), and John Laing Infrastructure Fund Limited (registered in Guernsey).

Canadian PPP Equity Sales (examples)

Year & Equity Seller	Project	Equity Purchaser (*Italicized* = tax haven registered)
2016		
Forum Equity Partners	Billy Bishop Toronto City Airport Pedestrian Tunnel, ON	Fiera Infrastructure
	Surrey Pre-Trial Services Centre Expansion, BC	
	Windsor South West Detention Centre, ON	
	Downtown Eastside social housing renewal, BC	
	Quinte Consolidated Courthouse, ON	
2014		
SNC-Lavalin	AltaLink energy transmission, AB	Berkshire Hathaway Energy
2013		
HOCHTIEF PPP Solutions	Alberta Schools (phase II), AB	Concert Infrastructure
Bilfinger Berger Project Infrastructure	Kelowna and Vernon hospital projects, BC	*Bilfinger Berger Global Infrastructure*
	North East Stoney Trail Highway, AB	
2012		
Bilfinger Berger Project Infrastructure	Gold Ears Bridge, BC	*Bilfinger Berger Global Infrastructure*
	Kicking Horse Canyon Highway, BC	
	North West Anthony Henday Drive, AB	
2011		
John Laing	Abbotsford Regional Hospital, BC	*John Laing Infrastructure Fund*
2010		
Macquarie Essential Assets Partnership	Sea-to-Sky Highway Improvement Project, BC	Fiera Axium Infrastructure, Regime de rentes du Mouvement Desjardins, and Nova Scotia Pension Agency
	Anthony Henday Drive Southeast Leg Ring Road, AB	
Bilfinger Berger	North West Anthony Drive, AB	*HICL Infrastructure Company*

Intoll (Macquarie Group)	407 ETR Concession, ON	CPPIB
Cintra (Ferrovial, Spain)	407 ETR Concession, ON	CPPIB
2007		
Macquarie Group	Abbotsford Regional Hospital, BC	*John Laing Infrastructure Fund*
Macquarie Group	Diamond Health Care Centre, BC	*John Laing Infrastructure Fund*
ABN AMRO	Abbotsford Regional Hospital, BC	*John Laing Infrastructure Fund*
2005		
ABN AMRO (retained 19%)	Abbotsford Regional Hospital, BC	Macquarie Group
ABN AMRO (retained 19%)	Diamond Health Care Centre, BC	Macquarie Group
2002		
Capital D'Amerique	407 ETR Concession, ON	Macquarie Infrastructure Group
SNC-Lavalin	407 ETR Concession, ON	Cintra

Source: Forum Equity 2016; Gordon 2014; Whitfield 2016.

Alternatives to Austerity and Public Infrastructure Financialization

If current trends are any indication, we are witnessing a transformation in fiscal policy. The 1950s and 1960s were a time of Keynesian-style federal spending through transfers, grants, and public bond debt. The 1980s and beyond were a time of deep cuts and downward cost shifting which led to an enduring infrastructure spending gap, witnessed later through aging and inadequate infrastructure. Today there is talk of resurgent public spending commitments to provide for the infrastructural underpinnings of economic growth and social prosperity but the financing needed to accomplish this is largely drawing on private capital markets through public-private partnerships and schemes increasingly embroiled in secondary financial markets. Even union and public pension funds are now implicated in the financialization and privatization of public works.

Direct public borrowing through bond markets is a viable policy option in Canada in light of the relatively low level of federal net debt (and the concomitantly high credit ratings enjoyed by all levels of government). Access to credit is not the issue, dissuasive ideology is. In this climate, new sources of revenue must be sought in order to close the current infrastructure gap in ways that do not simultaneously open up public infrastructure to revenue leaching through profiteering, equity sales, and offshoring.

Alternatives that would allow for greater democratic control and a wider range of policy options in the future include revenue from the activities of (as opposed to the sale of) state owned enterprises, sovereign wealth funds generated from mineral and oil and gas revenues, and public bond debt. Revenue bonds in particular, the form of public debt

most suited for infrastructure because it links debt repayment to public works activities, could be more widely used in countries like Canada where they are rare. Investor demand and government access to credit are not lacking, but supply is scant. Public debt remains seen, more often than not for ideological reasons, as imprudent and a sign of fiscal mismanagement. ***Resisting the easy lure of private consultants pushing private finance 'alternatives' must be made a priority***.

We might also consider: do we actually need a lot of new infrastructure? Certainly some new projects are needed but the comfortable coincidence of interests between large capital, private consultants, and austerity-minded governments ought to be critically examined. As Krugman (2016) points out, those projects most desirable for many jurisdictions are not likely to be those that enliven investors – sewer repair and upgrades, road maintenance, a new hospital wing. Further, commercializing infrastructure is often akin to regressive taxation – adding tolls and user charges that are not adjusted for income. A new element of the vicious austerity cycle is created when companies registered in tax havens siphon off earnings from public infrastructure: revenue for the government drops, as do Keynesian multipliers at home.

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