



MEMORANDUM

To
A C.L.C. Officers

From
De Andrew Jackson

Date June 29, 1993

Attached for your comments is a draft paper on the C.L.C. proposal for a National Investment Fund, following up on the economic policy paper passed at the 1992 Convention.

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TOWARDS DEMOCRATIC CONTROL
OF OUR ECONOMY
THE CASE FOR
A NATIONAL INVESTMENT FUND



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I: INTRODUCTION

The Economic Policy Statement "We Can Do It: Rebuild Our Economy" passed at the 1992 Canadian Labour Congress Convention put forward a proposal for a National Investment Fund, and mandated the Congress to publish a discussion paper on the nature, role and significance of such a Fund. The relevant paragraphs placing the proposed National Investment Fund in the context of the wider issue of democratic control of the economy are reproduced in the Appendix.

Three key points deserve to be stressed.

First, the case for a National Investment Fund flows from the failure of the existing investment system to help build a healthy and productive economy capable of providing full employment.

Second, the proposed Fund is seen a potential means to give "greater social direction to private capital". In other words, it is seen as an instrument of intervention in the existing investment process, an instrument which is needed to secure **different** objectives from those of private investors.

Third, the Fund is seen as a means of increasing direct labour and wider community involvement in the direction of the economy, at the national, sectoral and community level.

In essence, the proposal for a National Investment Fund calls for some **centralized pooling** of investment capital, to be allocated to specific uses on the basis of social investment criteria, and on the basis of "bottom up" initiatives.

This paper develops these points in greater detail, stressing the failures of the existing private investment system, and the need for more democratic control of the investment process. It also elaborates upon the possible structure of a National Investment Fund.

II: FAILURES OF THE PRIVATE INVESTMENT SYSTEM

In a "free market" economy, private capital is directed to particular uses by individual investors, enterprises and financial markets. The aim of participants in financial markets and the financial institutions which collect and direct the savings of individuals is to achieve the highest possible, risk adjusted rate of return. Mainstream economists see financial markets as "efficient" if they effectively steer the savings of society to their "best use", as measured by private rates of return.

There are two major reasons to call for greater regulation of financial markets. The first reason is to respond to "market failure", that is the failure of financial markets to actually do what they are supposed to do in a market economy. The second major reason is to achieve a different set of objectives than maximization of the private rate of return.

This section of the paper discusses the first reason for intervention, moving from widely acknowledged cases of "market failure" to a more general critique of the role of the financial system in our economy. The major argument is that, far from being "efficient", the existing system wastes capital on a massive scale, and has very harmful effects upon jobs and production in the "real" economy.

A] THE NARROW VIEW OF "MARKET FAILURE" - CONSERVATIVE BANKERS AND THE VENTURE CAPITAL GAP

Almost all businesses are dependent on outside capital for new investment, either in the form of equity (purchases of company shares by outside investors); or in the form of debt (borrowings from banks and other financial institutions, or direct borrowings from financial markets through company bonds.) Many businesses are justifiably critical of the responsiveness of financial markets to their needs.

It is widely recognized that financial markets and financial institutions are not very efficient in directing capital to certain important uses. Specifically, there is a widely recognized

problem of access to capital for business investment in so called "intangible" or "soft asset" areas such as research and development, engineering, marketing and worker training.

Part of the problem lies in the fact that, unlike a loan to finance purchase of real estate or machinery, a loan to a company to finance research or technology development produces no tangible asset which can be sold to pay off all or part of the loan should the investment fail to generate a return. Loans for intangible investments are far more risky from the point of view of financial institutions, even though the potential returns from such investments may be much higher.

This problem is compounded by the general inability of conventional financial institutions to properly calculate potential returns from such investments because of their lack of technical knowledge. Only an institution with technical expertise in, for example, computer software can judge the potential of proposed corporate investments in software development.

Many commentators also see a failure to adequately supply the capital needs of small businesses. It is argued that financial institutions like the banks are too cautious about lending unless the borrower has sufficient assets (collateral) to guarantee repayment of the loan. Small business establishment and expansion are thus limited by the personal assets of the owners of the business.

While governments have responded to these problems by providing a number of tax incentives, special lending programs and so on, it is now well established that the existing Canadian investment system fails to provide adequate capital to innovative, high productivity companies, particularly if these are small in size or new ventures.

Part of the failure relates to the lending practices of the banks and other institutions. Another important part relates to the relatively small and conservative venture capital industry.

Venture capital funds provide long-term equity financing for new ventures and smaller businesses undergoing expansion, and some funds specifically target companies which invest heavily in new technologies and research and development. Venture capital is of particular importance because it is provided on a long term basis, invested in the hope of a substantial future return in the form of share appreciation. Companies which gain access to venture capital can expand without having to pay out dividends on preferred shares, or interest on loans extended by a financial institution. This means that cash outflows in the early stages of a new venture are minimized, and that cash inflows can be ploughed back into the enterprise.

Noting that "investment is the most critical determinant of competitive advantage", Harvard University competitiveness guru Michael Porter identified several weaknesses of Canadian capital markets in the "Porter Report" (**Canada At the Crossroads**) commissioned by the federal government and the Business Council on National Issues. Porter noted that many sectors of Canadian business - particularly manufacturers, small business and innovative companies - have a major problem in terms of lack of access to capital on reasonable terms and conditions.

The banks provide 70% of financing for small and medium-sized companies which are generally unable to raise equity capital on stock markets. Porter notes that excessive insistence upon collateral for loans and lack of bank experience in evaluating the "soft assets" of innovative and high technology companies can limit investment driven expansion to the amount of capital that the owners themselves can provide. He also found that venture capital firms in Canada - those providing long term equity to start up firms or firms undergoing major expansion - are far more cautious than their US counterparts, and that the venture capital industry as a whole is relatively underdeveloped.

While Porter concluded that "there is little evidence that large Canadian companies have difficulty raising equity capital or other funds for business expansion" he noted that "businesses in non traditional sectors (high technology and knowledge intensive industries) as well as smaller companies in general face greater problems. The evolution and small size of Canada's venture capital market and the difficulty that many small early stage firms face in obtaining equity capital point to gaps in the adequacy of Canada's capital resources and financial system. Over time the lack of a vibrant early stage venture capital market is likely to limit the growth potential of knowledge industries in particular. Difficulty in accessing capital limits the ability of firms to upgrade technologies or establish new ventures. As a result, it serves to weaken dynamism in the economy as a whole." (p.202-3)

These broad conclusions have been echoed in a number of important reports. The Committee on the Financing of Industrial Innovation of the National Advisory Board on Science and Technology concluded in 1991 that "technology intensive firms in Canada in the start-up or early phases face severe difficulties in gaining access to capital" in part because of "lack of knowledge, understanding and experience among investors about the development of technology intensive commercial activity." The Committee found this failure to be extremely serious for Canada's future economic prospects and recommended the direction of private capital to industrial innovation through the imposition of tax penalties on institutional investors, as well as through the creation of targeted public investment funds.

The Ontario Investment Fund Discussion Paper released by the Government of Ontario in 1992 similarly noted a very serious problem of lack of access to capital on the part of companies making long-term investments in the "soft assets" which are central to the creation and expansion of innovative, high value added companies. Like the National Advisory Board, the authors of the paper pointed to a self-perpetuating cycle of failure based upon the separation of innovative industrial companies from institutional investors. The former tend to lack management and financial skills, while the latter lack knowledge of viable investment opportunities. The proposed solution was an Ontario Investment Fund mandated to provide "the long-term, patient capital needed to support innovative, high productivity companies."

B] INSTITUTIONAL LINKS BETWEEN FINANCE AND INDUSTRY: THE HIGH COST OF CAPITAL

Going beyond the now well established failure of capital markets to serve the needs of small and innovative companies, there is a growing consensus that a wider structural problem exists in terms of the relationship between finance and industry in the "Anglo Saxon" industrial countries - the United States, Britain, Canada, Australia and New Zealand. The argument is that the traditionally rigid separation between the banking system and industry in these countries has had negative impacts upon long-term industrial investment.

The cost of capital to industry (the real interest rate that must be paid on loans, or the cost of outside equity capital) varies between the major industrial countries, and this is an important variable affecting patterns of investment. Countries with a high cost of capital in the 1980s - the US, Britain and Canada - tended to have lower rates of investment in industrial machinery and equipment and research and development than countries with a lower cost of capital, most notably Japan and Germany.

One recent study found that rates of return on investment in research and development and machinery and equipment often have to be two to three times higher in the Anglo Saxon countries than in Germany or Japan before an investment will proceed. ("The Differing Cost of Capital." Financial Times (London) June 1, 1990). A 1992 study by the Canada Consulting Group similarly found that the average cost of capital after taxes and inflation in Canada and the US between 1978 and 1988 was double that in Germany and Japan (4.8% and 4.9% compared to 2.5% and 2.0%). This ultimately translates into lower rates of productivity and job growth,

lower wages and living standards, and a loss of domestic and export market share to rival companies.

Many factors come into play in determining the cost of capital - such as the rate of inflation, the nature of the tax system and so on. Among these factors is the nature of the financial system. As a recent article in the Financial Times of London put it, variations in the cost of capital between countries "reflect less the abundance of capital in Japan and Germany relative to the US or Britain than the method of delivery of that capital. ("The Differing Cost of Capital." June 1, 1990.)

Industrial companies in Germany and Japan depend much less upon loans from banks than their US, British and Canadian counterparts because German banks are generally willing to take up long-term equity positions, and because the system of large industrial conglomerates in Japan gives individual companies ready access to internal sources of financing for new investments. The availability of long-term, relatively low cost "patient" capital permits relatively high rates of investment in "soft assets" and stretches out the period within which the cost of investment must be recouped.

There is a growing consensus in the United States that there is a systemic problem with the investment process such that even equity capital is not directed to the most productive companies and the most productive investment projects, as measured by rates of return on private investment.

In a major recent study of the US system co-ordinated by Michael Porter, a key distinction was drawn between the "fluid" capital market typical of the Anglo-Saxon countries and the "dedicated" capital market typical of Japan and Germany. (See Michael Porter. "Capital Disadvantage; America's Failing Capital Investment System" Harvard Business Review. September - October, 1992.) In the former, capital markets are driven by the desire to maximize short-term returns, and this perspective is typical of both individual investors and institutional investors such as pension and mutual funds. Shares tend to be frequently traded in search of a quick profit, resulting in a lack of close ties between management and outside investors. In Germany by contrast, there are continuing, very close ties between industrial companies and outside investors, typified by the substantial equity position often taken by the banks in major companies. The goal of the banks in such a system is long-term appreciation of the value of their shareholdings, which are infrequently traded.

This long-term perspective is buttressed by an intimate knowledge of the internal workings of the company on the part of outside investors, which permits an informed judgement

of the prospects for return on long-term investment projects. It is on that basis that "patient capital" is extended.

Porter also draws a distinction between the typical focus of the managers of a German and Japanese company upon securing the long-term position of the company relative to competitors (with respect to market share, technological advantage etc.) and the focus of typical US managers upon measurable short-term financial rates of return on investment. These differences are not just "cultural" but reflect differences in the nature of capital markets.

The overall consequence of these differences is that US - and Canadian - companies typically invest at a lower rate and with a shorter time horizon than do German or Japanese companies, with negative long-term impacts upon productivity, the competitive position of the company, and thus ultimately upon jobs. The problem is related to the nature of the financial system because institutional investors in equities such as pension and mutual funds typically involve themselves very little in the internal workings of the companies in which they invest and have no long-term commitment to a particular company. Even more importantly, the problem is a problem of the financial system because the banks and other financial institutions do not typically take up an equity position at all. In both cases, there is a clear separation of outside investors from management, which results in a reluctance to invest for the very long-term, and a reluctance to finance risky investments (for which detailed information is lacking.)

While other non-financial factors such as the overall growth rate of the economy, the level of interest rates, the nature of the industrial structure and so on were clearly at play, there can be no doubt that investment in Canadian industry fell well short of levels in other industrial countries in the 1980s. Between 1980 and 1989, business investment in machinery and equipment in Canada averaged 6.5% of GDP, compared to 8.1% in the US and 8.5% in Germany. This helps explain the slower rate of adoption of new technologies in Canadian industries compared to Germany, the US and other countries. Business investment in research and development averaged less than 1% of GDP, far below the level of most other advanced industrial countries. The same is true of investment in worker training.

One factor in explaining under investment is the continued distance between Canadian industries and Canadian financial institutions. Only a trivial 4% of the total assets of Canadian banks and trust companies are held in the form of corporate securities, and the traditional banking role of lending working capital to business has itself declined in importance compared to lending to individuals (though \$119 Billion of total Canadian bank assets of \$457 Billion consists of business loans.)

For larger companies, capital for investment is generally obtained less from banks than from internal sources, from equity markets, or from direct bond borrowings. As in the US, outside individual and institutional equity investors tend to have distant relations with management, and tend to trade shares frequently in order to maximize short term returns. (That said, as is again the case in the US, large pension funds are beginning to act more as long-term investors given the difficulties of frequently trading very large share holdings.)

C] **FINANCE AND THE REAL ECONOMY -
CONSEQUENCES OF DEREGULATION**

"When the capital development of a country becomes the by product of the activities of a casino, the job is likely to be ill done" - Keynes.

A more profound critique of the financial system goes beyond gaps in capital markets and "short termism" to argue that the existing financial system is a very poor instrument for allocating capital between different purposes, and has itself become an extremely destructive economic force.

In the aftermath of the Great Depression - itself caused in large part by the orgy of financial speculation and overextension of credit which led to the collapse of the US banking system - most countries placed strict controls upon financial institutions. In Canada, as in the US, the level of bank lending was controlled by government owned central banks, and regulators carefully monitored the maintenance of "prudential" (conservative lending) standards. Different kinds of financial institutions (banks, trust companies, insurance companies, securities traders) were created with different powers, each operating within distinct spheres with the effect that competition was limited. Interest rates were closely regulated and credit was sometimes rationed through means other than interest rates, such as a minimum equity share in a home or business purchase. Capital flows between countries were regulated, and generally restricted to the transactions necessary to finance international trade and investment flows (which were themselves quite modest for most countries in the first two decades after the War.) Exchange rates between currencies were generally fixed until the Bretton Woods system collapsed in the 1970s. **The key point is that finance was a very closely regulated sector in most of the industrial countries until well into the 1970s.** Indeed, important controls still exist in many countries.

In Canada, regulation went less far than elsewhere, and was dismantled relatively early. Interest rate ceilings and exchange controls have not existed for many years, and Canada was one of the first major industrial countries to abandon fixed exchange rates. The federal government and the Bank of Canada intervene very little in the lending decisions of banks and trust companies, beyond maintaining "prudential" standards. (These have maintained a more stable financial system than that of the US, though one by no means immune to bankruptcies in the 1980s.) The volume of financial institution lending is no longer affected by central bank reserve requirements, (compulsory no interest deposits with the Bank of Canada no longer exist) and there is no regulation to steer lending to particular purposes as opposed to others. There are few restrictions on international operations and the barriers between the operations of different kinds of financial institutions have been progressively, though not completely, dismantled. In short, the regulatory role of government is minimal.

Internationally and nationally, deregulation has taken the form of the near elimination of restrictions on the international flow of financial capital, which has stimulated global competition between financial institutions and a "hands off" government attitude towards the investment decisions of financial institutions. For their part, financial institutions have taken advantage of deregulation to introduce a dizzying array of new financial products and services. Financial innovation has been a response by the banks to growing competition and a loss of traditional business to other institutions.

Banks no longer just lend money to households, companies and governments. Now they "bundle" loans and sell them to investors, or other banks. They also deal in "new financial instruments" such as currency and interest rate options, futures and swaps. Total global issues of such "derivatives" grew seven times to a total of \$7.6 trillion in 1991. (Harold Rose. The Changing World of Finance and Its Problems. British-North American Committee. 1993 p.8.) Financial activity has grown to frenzied levels as new markets have been created, and as trading in "securitized" products has grown. For example, daily trading of US Government securities was \$400 Billion in 1990, out of a total US Treasury marketable debt of \$3.4 trillion. On average, the entire volume of such debt is thus turned over every 8 days. (International Capital Markets. Exchange Rate Management and International Capital Flows. The International Monetary Fund. 1993.)

Deregulation has been a major source of instability and of outright waste of capital resources by financial institutions, particularly in the US, Canadian and Britain where the deregulation process went the furthest.

As noted in a recent survey in *The Economist*, banks in these countries made "three breathtaking blunders in the 1980s". They added "either you have to suppose that the genuinely clever men who run today's banks proved third time consecutively unlucky during the 1980s, or you must suspect that there are flaws in their system." ("Banks in Trouble" *The Economist*, September, 8, 1990.)

First, the banks recycled the huge surpluses generated by the oil producing countries in the mid to late 1970s by extending enormous loans to the Lesser Developing Countries, with remarkably little examination of how those funds were used, or realistic prospects for future repayment. Much of the credit extended was immediately consumed by often corrupt governing elites, rather than invested so as to produce future returns. These loans ultimately resulted in a massive international debt crisis which has yet to be fully unwound, and has set back development in much of Latin America, Africa and many other countries elsewhere by a decade and more.

Rather than risk the very real threat of a collapse of the international banking system which could have been caused by a wholesale debt default, the major industrial countries, the International Monetary Fund and the World Bank imposed draconian austerity programs on the debtor countries which slashed living standards and resulted in a huge net transfer of funds from debtor to creditor countries over most of the 1980s. While only some 20-30% of the funds loaned out will ultimately be repaid, there has been a substantial net transfer of funds from debtor to creditor countries over the past decade because new credit became all but unavailable.

Canadian banks were major participants in this disaster, and have written off about \$10 Billion of their LDC loans, 71% of their gross exposure. (ISTC Profile of Canadian Banks) These losses were effectively transferred to taxpayers through sharply reduced taxes on bank profits, and to all other lenders in the form of the higher charges and higher interest rates imposed to repair bank balance sheets.

Second, the banks - particularly the US banks - financed the corporate merger mania of the mid to late 1980s in the form of bridging loans to finance Leveraged Buy Outs and/or purchases of the corporate "junk bonds" issued by companies to finance mergers and acquisitions. Many of the multi billion takeovers of the period resulted in absurd levels of debt. (On average the equity share following a leveraged buy-out or LBO in the US fell to 12%). Excessive debt then often led to the quick collapse into bankruptcy of once viable companies, even before the economy as a whole went into a recession. Many investment banks took a beating in the process. Huge fortunes - including Canadian fortunes - such as that of Robert Campeau were lost on speculative LBO transactions backed to the hilt by the banks.

Other investors profited from the run up in share prices which typically took place before a takeover was completed. Studies show that the windfall gains to holders of company shares and the investment banks and corporate lawyers which put the deals together were mainly paid for by workers, as the new owners of over-leveraged companies desperately tried to pay off their huge debts by slashing wages and cutting jobs. Even very conservative economists see the merger mania of the 1980s as an incredibly destructive process which destroyed jobs and sound companies to no good purpose.

While merger and acquisitions activity in Canada was not even close to the frenzied levels of the US, there were several multi billion takeovers in the late 1980s. In the energy sector alone, there was the acquisition of Dome by Amoco (\$5.2 Billion); the takeover of Imperial by Texaco (\$4.9 Billion) and the takeover of Gulf by Olympia and York (\$2.8 Billion.) These multi billion dollar transactions were financed in large part through funds raised from financial markets, but these borrowings resulted in no new investments in productive capacity.

As in the US, the late 1980s saw an increase in corporate debt levels far beyond those needed to finance real additions to productive capacity. Between 1985 and 1990 the debt of Canadian non financial corporations rose from 97% to 99% of GDP, even though a period of growth and high profits could have been expected to result in an improvement of firm's financial positions (Rose p. 25) Much ingenuity and borrowed money went into corporate re-organization, while real productive investments lagged other countries, in part because corporate cash flow went to service unproductive debt.

Third, bank lending fuelled the huge inflation of real estate values in the 1980s, affecting housing and commercial real estate from London to Toronto to California. Banks lent on the basis of rising real estate values, encouraging more and more speculation and more and more lending, until the whole edifice collapsed from unsustainable values. Once asset values fell, borrowers found themselves overextended, often holding mortgage liabilities far in excess of the worth of the property acquired. Commercial real estate empires such as Canadian owned Olympia and York have gone under in the last two years, resulting in a huge increase in "non performing" bank loans. The Canadian banks exposure to Olympia and York alone is well in excess of \$3 Billion.

Between 1981 and 1985, a total of \$25.7 Billion was invested in construction in Canada in the trade, finance and commercial services area (that is in office buildings, shopping centres etc.) This more than **doubled** to a total of \$52.2 Billion in the years 1985-90. (For purposes of comparison, this was two-thirds as much as the \$72 Billion invested in machinery and

equipment in the manufacturing sector between 1985 and 1990, which represented a far smaller 60.5% increase from 1981-85).

It is clear that there was massive over-investment in commercial real estate in Canada in the last half of the 1980s - with the results visible today in stratospheric vacancy rates for offices and retail space in major urban centres. While the recession has played a role, investment went far beyond what was reasonable in the circumstances. Beyond the bankruptcy of major real estate developers and owners, the banks and other lending institutions have suffered large loan losses as a result. In 1992 alone, the banks made loan loss provisions totalling \$6.5 Billion, and the Canadian trust companies made loan loss provisions for another \$1 Billion. A large share of these losses is explained by defaults on commercial mortgages and loans to property developers.

Residential real estate values also increased excessively in some urban centres, particularly Toronto, in the late 1980s. Toronto house prices have fallen by more than 20% from recent highs, pushing some borrowers into a "negative equity" position. While demographic factors were important, aggressive bank lending played a role in real estate inflation. Between 1985 and 1989, the total amount of funds lent out for mortgages grew by 14% per year. Financial institution mortgage lending of all kinds rose to a record high of \$35 Billion in 1989, and averaged more than \$30 Billion from 1987 through 1990. (Department of Finance Reference Tables. Table 83.) Investment in residential real estate rose to a record high average of 7.3% of GDP 1987-89, and peaked at more than 7.5% in 1989.

It is common for conservative economists to talk of government borrowing "crowding out" business borrowing for investment, to the detriment of the future of the economy. Yet the growth of household and business indebtedness in the second half of the 1980s was significantly greater than the growth of government indebtedness, and much of this growth is to be explained by an uncontrolled and ultimately destructive overexpansion of credit by the banks and other private financial institutions.

An even greater explosion of unproductive and ultimately unsustainable private debt took place in Britain and the US. In Britain, the manufacturing sector languished during the Thatcher "economic miracle", driven by a housing and consumption boom which ultimately collapsed leaving households heavily in debt. In the US, real private investment in industry and public investment suffered as hundreds of banks lent themselves into bankruptcy through real estate loans and junk bond purchases. The Savings and Loans collapse ultimately cost US taxpayers a staggering \$300 Billion. A recent report for the conservative British - North American

Committee by Harold Rose notes that banks generally are now in worse trouble than at any time since the Great Depression because of the "folly" of bank managers.

The excessive growth of private debt in the expansion of the 1980s has been identified as a major factor in the current economic crisis by the Organization for Economic Co-operation and Development. (See OECD Economic Outlook, December, 1992 p. 41-49.) In Canada, household debt rose from 50% to 60% of GDP between 1984 and 1990, and debt servicing costs rose from 7% to 10% of personal disposable income. According to the OECD "the most fundamental cause of these developments (rising personal and corporate indebtedness) in all countries was the failure of economic policy to recognize the implications of financial liberalization." In the view of the OECD, "liberalization" - that is the removal of a wide range of controls on financial institutions - resulted in an erosion of credit standards and an overextension of debt, which fuelled inflation and then led to a collapse in asset prices. This has left several OECD countries - particularly the Anglo-Saxon countries - with high household and corporate debt levels which must now be serviced from stagnant or even falling incomes, with a very depressing effect upon both consumer spending and business investment.

**DJ FINANCE AND NATIONAL DEVELOPMENT -
THE COSTS OF "GLOBALIZATION"**

Canada dismantled controls on international capital flows much earlier in the post War period than most other countries, and there are very few barriers to the outflow of private Canadian capital to other countries. One of the few remaining restrictions - the restriction of RRSP and pension funds to investments in Canada - is itself being liberalized, and the portion of such funds which can be directed to foreign investments is being increased to 20%. There are no restrictions on the ability of Canadians to sell Canadian dollars to purchase foreign currency or foreign assets such as stocks and bonds. In short, Canada is more or less fully integrated into global capital markets.

The price of such integration has been a substantial outflow of private Canadian savings. Between 1986 and 1991, Canadians purchased \$16.3 Billion of foreign stocks, more than double the \$7.3 Billion of Canadian stocks purchased by foreign residents over the same period. (Department of Finance Reference Table 70. International Payments: Capital Movements.) Over the same period, direct investment abroad by Canadian companies (ie purchase or acquisition of a substantial equity stake in a foreign company) totalled \$36.4 Billion, almost \$10

Billion more than the \$25.5 Billion of foreign direct investment in Canada. Also between 1986 and 1991, Canadians purchased more than \$5 Billion of foreign bonds, though this was vastly outweighed by Canadian bond borrowing from foreign residents.

Overall, Canada is a major net importer of capital because of the large outflow of interest and dividend payments on accumulated foreign investments in Canadian securities. Within that context, there are substantial outflows of Canadian private savings. If those savings were retained within Canada, the amount of net borrowing which would have to be undertaken in foreign capital markets would be reduced.

The most significant point is that more or less complete integration into global capital markets means that an investment in Canada must - on a risk adjusted basis, and taking into account expected fluctuations in exchange rates - match the highest rate of return available in the world. Investors will demand that the rate of return on Canadian stocks and bonds match that available to them in the US, Japan or any other country similarly integrated into global markets.

E] THE GLOBAL CASINO

During the 1980s, there was a massive change in the nature of international financial markets, driven by new computing and telecommunications technologies, the dismantling of the capital controls which existed in many industrial countries into well into the decade, the development of new financial "instruments" such as currency futures, and the deregulation of domestic financial markets which allowed many more financial institutions to participate in "global" activities. The result was a massive explosion of international financial transactions.

Between 1980 and 1991, annual international bank lending (defined as cross border loans plus lending to domestic residents in a foreign currency) increased twenty fold from \$324 Billion to \$7.5 Trillion, equivalent to almost half of the total output of the industrial countries belonging to the OECD. Annual cross border transactions in equities totalled \$1.4 Trillion in 1990 as investors in all countries increasingly diversified their holdings to include shares traded on stock markets around the world. As of the end of 1991, there was \$1.7 Trillion of international bonds outstanding, and the global stock of foreign direct investment also stood at \$1.7 Trillion. (Data from "Fear of Finance" The Economist. September 19, 1992 and "Survey of International Banking The Economist. April 7, 1990.)

Canadian banks are very active on the "real" side of international finance. About one third of the total business of the Canadian banks in terms of both deposits and lending is in foreign operations. The Canadian Life and Health Insurance companies are also very active in foreign markets, collecting about one third of their premium income in foreign countries (mainly the US) and investing a far greater share of their assets overseas. While they have lost ground in recent years, the Canadian banks remain significant "global" players.

In addition to traditional lending activities in support of international trade and investment, international banks are engaged in the churning of capital for almost purely speculative purposes. The foreign exchange (forex) market has grown at a phenomenal rate over the past few years as large companies, institutional investors and the banks themselves have sought quick returns in currency trading, including the trading of currency swaps and futures. The **daily** value of foreign exchange transactions in all countries is now almost \$1 Trillion, only a small fraction (much less than 10%) of which is needed to finance "real" trade and investment flows. The balance is purely speculative trading. (See International Capital Markets. Exchange Rate Management and International Capital Flows. The International Monetary Fund. 1993.)

Canadian financial institutions have been major participants in the new global financial markets. The Bank of Canada (October, 1992 Bank of Canada Review) reports that the foreign currency trading activity of the Canadian banks grew to \$28 Billion per day in 1992, about the same as the total of all wages and salaries paid out to all Canadians in a month. In both 1991 and 1992, the big 5 Canadian banks made about \$1 Billion in profits on this frenetic buying and selling of foreign currencies. (Financial Post. January 23, 1993.) The banks trade both on their own account and, more commonly, through short term loans to institutional investors wanting to participate in the forex market.

F] CONSEQUENCES OF DEREGULATION AND "GLOBALIZATION"

One consequence of deregulated, "globalized" capital markets is that national governments have all but lost control of their own currencies. It is now generally recognized that purely speculative transactions can drive currencies away from values which reflect "fundamental" economic realities for long periods of time, resulting in acute adjustment problems for the "real" economy.

Another consequence is that it is vastly more difficult for a country to lower domestic interest rates in order to stimulate production and jobs. It is always possible to raise interest rates above international levels to depress the economy - as was done by the Bank of Canada from 1988 on -but much more difficult to do the opposite. Indeed tight monetary policy in one country - as in Germany today - will tend to drive up interest rates around the world, but it is then difficult for rates to drop unless there is a co-ordinated reduction on the part of the major countries. **Globalization has thus resulted in a strong bias towards high interest rates and slow growth in the international economy.**

As noted above, globalization and deregulation have helped fuel an explosion of bad debt and purely speculative financial activity - effectively squandering capital that could have been directed to more productive "real" uses. The prospect of quick returns on purely financial transactions - such as currency trading and Leveraged Buyouts - has tied up huge sums of capital, thus forcing up the cost of capital to businesses wishing to finance "real" investments in machinery and equipment, new plant, research and development etc.. Government borrowing costs have also been forced up, with negative impacts upon the level of public investment. Speculative finance has also sunk otherwise viable firms and destroyed jobs.

Finally, globalized financial markets have tended to break down separate national capital markets. This has gone furthest in countries like the US and Canada, where the links between financial institutions and industry have historically been quite weak, but the relative insulation of countries like Germany is starting to break down. The major consequence is that investments are only undertaken if the risk adjusted rate of return is competitive with the highest potential rate of return available anywhere in the global economy.

III: THE CASE FOR SOCIAL CONTROL OF INVESTMENT

AJ PRIVATE VS. SOCIAL RATES OF RETURN

The above section has detailed some of the failings of the private investment system which result in under-investment in key sectors and areas of economic activity, in wasted capital resources, in destructive financial speculation, and in erosion of the capacity of states to intervene in the economy to secure important national objectives such as job creation and stable growth.

The private investment system fails on even more fundamental grounds. The driving purpose of the system is to maximize the rate of return on capital to private investors. "Free market" economists tell us that such a system will result in the most efficient allocation of capital to competing uses. But "efficiency" is a very narrow concept, which fails to measure the contribution of investment to a wide range of possible economic and social objectives.

Some economists usefully draw a distinction between the private and the social rate of return on an investment. An individual investor will, in reviewing a decision such as whether or not to invest in new machinery and equipment for an old plant, weigh the likely private return from such an investment against a wide range of possible alternatives.

In the world of the abstract economic models, a decision not to invest in a particular plant in a particular community is of no consequence, since it will be balanced off by a more "efficient" investment elsewhere in the economy. Yet that decision not to invest may have profound consequences for others in the society. If a decision not to invest leads to a plant closure, workers losing jobs will become unemployed if the plant is in a region of high unemployment, and may have to move out or suffer from long term unemployment. Local businesses and suppliers will, at a minimum, suffer an erosion of revenues, hindering their own prospects for expansion. The local tax base will fall, imposing additional costs on remaining employers and undermining the existing level of public services. If displaced workers do not find other jobs, they may become dependent on income assistance programs, and the taxes they pay to all level of government will fall.

The central point is that there are significant social consequences attached to private investment decisions which are not taken into account by the private investor.

If the economy were operating at or very near full employment, it would matter rather little to workers and communities if the process of investment and disinvestment resulted in plant closures, layoffs or the discontinuance of some business operations, since these would be balanced off by new job opportunities elsewhere. Indeed, in the world of the economic models, the new jobs would be likely more productive and better paid, since they would reflect a more efficient use of capital. **Yet, in a nation which is very far from full employment, the employment consequences of disinvestment decisions must be taken into account. If no alternative jobs are readily available the social costs of a private disinvestment decision will be high.**

Further, and most importantly, in an increasingly "global" economy, the decision to disinvest will not be more or less automatically counterbalanced by a decision to invest the available funds elsewhere in the economy, since the alternative investment may well be outside the country. In such an economy, disinvestment can affect not just individual businesses, but entire sectors, communities, regions and even the country as a whole. This is exactly what has been happening to Atlantic Canada for the past decade and more, and to the manufacturing sector since 1989. Disinvestment in the form of complete and partial business shut-downs has completely eclipsed new investment, resulting in a significant net loss of productive capacity and a permanent loss of jobs.

Beyond the impacts upon individual workers and communities, disinvestment decisions can have important negative consequences for the structure of the economy. In some, increasingly common, instances, a disinvestment decision can result in the more or less permanent loss of production capacities in particular sectors and industries. This can have serious, self-reinforcing long-term consequences.

To take one example, because of past investment and disinvestment decisions, Canada has an extremely small machine tool sector by comparison to other industrial countries. Lack of investment becomes self-perpetuating, since purchasing industries such as auto and forest companies develop close relationships with foreign suppliers; since domestic companies become confined to narrow niches in the market; since failure to develop or retain a sector results in severe skill shortages or the complete absence of needed skills, deterring new investment; since the lack of a domestic industry results in weak or absent knowledge of domestic and export market opportunities, and so on. **To a very great degree, present success is a condition of**

future business success, since it generates the capacities, skills, knowledge of the market and other attributes needed by a business to plan and successfully deploy new investments.

This insight has led many countries to regulate or subsidise investment in order to retain or build-up "strategic" sectors. Sectors can be considered strategic for a wide variety of reasons. They may provide key inputs without which other, dependent sectors would be placed at a disadvantage (eg. chips for the computer industry). They may provide a large market for supplier industries, thus generating large spin-off benefits to the whole economy which would disappear if the core industry were to contract (eg. the auto industry, aerospace.) (The manufacturing sector is of particular strategic importance since more than 4 jobs are generated by each manufacturing job.) They may develop skills and capacities needed in many other sectors (eg. Quebec Hydro was a key generator of technical skills and capacities among francophone Quebecers in the 1960s and 1970s). They may provide jobs for particular groups of workers who would otherwise face particularly high risks of unemployment (eg. the clothing industry, which employs a high proportion of minority women who often lack the language and other skills needed to obtain other jobs.)

The key point is that disinvestment and investment decisions have significant consequences for the structure of the economy as a whole, which are not captured by the rates of return on private investment.

It is now well established in the economic literature that private rates of return on investment fail to capture the full benefits to the economy of many major investment decisions, thus justifying an "active industrial policy" based upon subsidies. For example, the decision of European governments to subsidize the Airbus project reflected the fact that the returns to the EC economy as a whole - in terms of building important new capacities in the aerospace industry and in supplier industries - went far beyond the (negative) rate of return which would have faced private investors judging Airbus on a stand alone basis. In the absence of a subsidy - effectively a partial socialization of the investment decision - Europe would have been almost completely marginalized in the passenger aviation industry, which would have remained dominated by US based companies. Those US companies - subsidized in the past through the US defence program - would then have been in a position to earn above average profits (or "rents") based on insulation from competition.

The same pattern is true of many industries which require large capital investments or large, risky investments in technology or innovation. **The potential returns to a country which captures a significant share of a technologically sophisticated industry are high, but the risks and costs of entry into the competitive game are usually prohibitively high for late**

entrant businesses challenging well established leaders. Partial socialization of the costs of investment thus tends to be a precondition for industrial "catch up." This is to be seen in the experience of successful Newly Industrializing Countries such as Korea which provided cheap long-term capital to the export oriented industrial sector. (See Stephen Smith. *Industrial Policy in Developing Countries: Reconsidering the Real Sources of Export-Led Growth*. The Economic Policy Institute. 1992.) Such countries also had to use subsidies and managed trade to develop the technological capacities which would have been throttled at birth by full exposure to international competition.

It is also well-established that certain kinds of investments yield much higher rates of return to the economy as a whole than they do to the individual investors who make the initial investment decision. This is true of investments in training by an individual employer, who will likely "lose" some of the investment as trained workers quit to take new jobs. Yet the skills obtained by the worker are not lost to the worker or to the economy as a whole. Similarly, a company investment in research and development will often, above and beyond the return to the company, produce knowledge and competencies which can be accessed relatively easily by many other companies. Northern Telecom and Bell Northern, which run by far the largest R and D program in Canada, have developed Canadian competencies and skills which have been drawn upon by many smaller companies, often founded by former employees. Large corporate research and development programs also develop competencies among suppliers, which themselves become the basis for new innovations and investment.

B] ECONOMIC RETURNS AND INVESTMENT DECISION - MAKING

It is generally understood that there are some kinds of investment which make sense for the community as a whole in terms of generating good rates of return, but which are more appropriately financed by society as a whole than by private investors. We invest in public infrastructure such as roads, highways, sewers, airports, bridges, railways, canals, telecommunications networks, public postal services and so on because good public infrastructure contributes to the productivity and efficiency of the economy as a whole, and because private provision would tend to result in under-investment, or in undesirable consequences such as private monopolies. As a society we invest in public education because we recognize that a well educated population contributes to our future economic well-being. The alternative of expecting parents to directly finance the education of their children would result in under-education of the poor.

We also, of course, invest in many areas for non economic reasons. Education is valued not just because of the higher future productivity and incomes of educated workers, but because education contributes to the development of human capacities, and empowers individuals to lead fuller and more rewarding lives. Education is also vital to the functioning of a truly democratic society in which individuals fully participate in the social decision - making process. By the same token, investment in health care has an economic dimension - sickness reduces available resources - but we also value health as a good in its own right. The United Nations has constructed a human development index which ranks countries on the basis of human well-being - as measured not just by incomes, but also by level of education and health. Strikingly, such a ranking is quite different than one based just on national income. The social priorities of countries -and thus their relative allocation of funds to social investments - differ.

The term "social investment" is often used to refer to investments made for non economic, or in large part non economic, reasons. Education and health are the two key examples, but many more can be added. We can invest in social housing, constructed not to generate a return on capital but to decently house low income households and persons. We can invest in pollution control systems which add to production costs so as to promote environmental values. We can invest in parks and recreation facilities in order to give people access to opportunities of which they would otherwise be deprived.

The key point is that creating a "good society" which meets human needs requires that investments be made in many areas for primarily non economic reasons. This in turn means that the resources have to be diverted from either private consumption or from private investment.

IV: DEMOCRATIC CONTROL OF INVESTMENT DECISION - MAKING

The investment process can be "socialized" - made subject to criteria other than private rates of return - in a wide variety of ways. Funds can be collected through taxation or borrowed by the state, and then spent directly on social investments, public infrastructure and so on. State funds can also be transferred to crown corporations operating within a market economy. In short, the state and its agencies can substitute for private investment.

The state can also intervene in the private investment decision-making process. This can be done through the tax system, which shapes market decision-making in many ways. Commonly, individual investment is promoted over consumption by taxing property income at preferential rates (eg. through the capital gains exemption, partial non taxation of capital gains, the dividend tax credit etc. and by taxing consumer spending. Through the tax system, governments thus attempt to raise investment while discouraging consumption. Strikingly, however, the state intervenes little to direct the private savings it helps generate through the tax system by expensive tax breaks for the affluent.

Corporations are induced to invest in some areas as opposed to others through special tax measures such as the research and development tax credit, and the lower corporate tax rate for manufacturing businesses. Some categories of business, such as small business, are given preferential tax rates.

In addition to tax measures, governments often - though less commonly - provide subsidies for particular investments, such as new investments in regions of high unemployment, investments in financially troubled companies, and investments in sectors deemed to be of strategic importance.

The state also intervenes directly through regulation of private businesses, which may be required to invest in pollution control or in areas such as worker training.

Finally, the state may intervene by regulating the decisions of financial institutions. Beyond fiduciary and prudential standards, this tool is little used at present. Private institutions are left relatively free to channel funds to areas promising the highest potential rate of return.

The central point is that investment decisions are made by either "the market" - that is by individuals, companies and financial institutions seeking to maximize private rates of return - or by the state, which may act either directly or indirectly to shape the investment process. The tax system is now by far the most preferred instrument of state intervention, and even here the trend has been very much towards creating a "neutral" system which "interferes" as little as possible with "market signals". Thus the wide array of corporate tax incentives which existed in the 1970s and early 1980s has been whittled down considerably. Canadian governments now intervene rather little through regulation or through the provision of direct investment subsidies, and the public sector itself is largely confined to the provision of infrastructure. **Following a decade and more of privatization, deregulation and "free trade", the sway of "the market" has been vastly increased in investment decision making, and the sway of government has been severely limited.**

The labour movement has long called and continues to call for greater social intervention in the investment process through state action. Beyond social investment in areas like health and education and investment in infrastructure, we see a role for public ownership, regulation and subsidies as part of an active industrial and economic development policy.

That said, the division of labour between business and the state raises questions from the point of view of democratization of the investment decision-making process. Essentially it means that the social criteria brought to bear upon that process are those of governments, or those filtered through the government policy process. Governments are, to be sure, democratically elected and are accountable to citizens, and many of their decisions are the product of conscious social choices. For example, governments are elected or defeated on the basis of pledges to increase social investments, or to reduce them; to raise public investment, or to cut taxes, and so on.

There remain major problems in that governments are inevitably quite centralized, and lack detailed knowledge of specific sub sectors of the economy, and the needs of particular regions and communities. While there have been many examples of successful sector level industrial policies, governments are ill equipped to judge the investment alternatives facing all but the largest individual companies, since such judgements require a comprehensive knowledge of the specifics of technology, production processes, markets and many other factors. While there is certainly scope for a government industrial policy which shapes the investment process in major industrial sectors and strategic technologies, any attempt at comprehensive planning of the private investment process would confront the great complexity of the economy as a whole. This has been increasingly recognized in democratic socialist criticisms of centralized economic planning. (See Geoff Hodgson. *The Democratic Economy*. London. 1984.)

The point is not that most investment decisions must be left to the market, but that social regulation of the investment process must be decentralized and democratized. Rather than decentralize the decision-making process to "markets" - that is to individual enterprises and financial institutions - decentralization should be to institutions within which interests other than those of private investors are represented. Further, non business interests with objectives other than maximization of the private rate of return should be represented in the government decision-making process.

The labour movement is increasingly recognizing the need to intervene in economic decision-making at a level pitched somewhere between the still central activities of collective bargaining and participation in the political process. Traditionally, unions have bargained for better wages and working conditions for their members - and for greater control of the individual workplace - but corporate investment decisions have rarely been directly influenced by negotiations. Unions have seldom been consulted in decisions about what to produce and how to produce it, except insofar as these managerial decisions impinge upon the labour process itself. The implementation of technological change and training decisions do become subject to bargaining, but this arises from the negotiation of work rules (job descriptions, seniority etc.) rather than because of any serious erosion of "management rights".

Unions almost never have any control over disinvestment decisions, except in so far as income guarantees achieved through bargaining can act as a disincentive to major layoffs or plant closures. Nor can unions stop employers from gradually running down an operation over a period of time because of a failure to reinvest and retool. Even in countries like Germany where workers have strong "co determination" rights, the scope of such rights is generally limited to workplace organization issues (though some control is exerted over layoffs). The same is true of almost all "employee involvement" plans which have been negotiated with unions. At best, workers through their unions can gain some control of the work process, but strategic investment decisions remain with the employer.

Beyond the individual workplace, some unions have begun to participate in sectoral joint business - labour organizations with some involvement in the restructuring process. Existing joint sectoral bodies in the steel, auto parts, forestry and other sectors (with more in the process of formation) develop and deliver training programs for workers in the sector, providing certification for skills which are needed by more than one employer.

It is possible to envisage such joint sectoral bodies broadening their mandate beyond training issues, and some encouragement has been given to this process by the establishment of the Sectoral Partnership Fund by the NDP government in the Province of Ontario. In the auto

parts sector, consideration is being given to the creation of joint centres which might lease out new machinery and equipment to companies, and provide joint "best practice" advice on how new technologies should be used, associated training requirements etc..

In other sectors, unions have attempted to enter into a dialogue with employers over future development plans and the measures needed to retain and increase the level of production and employment in Canada. Provincial government industrial policies - such as the recently initiated forest industry development strategy in BC and the sectoral strategies recently initiated in Quebec - are being developed on the basis of input from both business and labour. The sectoral planning exercises undertaken by the federal government in the late 1970s saw the preparation of quite detailed sectoral plans on the basis of labour input. Yet - like business - governments still tend to see unions as "non players" outside rather narrowly limited industrial relations issues.

Unions with close involvement in particular sectors (auto, steel, forest products, mining, energy, transportation, chemicals, telecommunications etc.) have a good understanding of the economics of the sectors in which they operate, and often have excellent proposals to put forward on how these sectors might be deepened and developed. Even more importantly, unions speak for objectives other than the private rate of return on investment - objectives such as job creation; the creation of more skilled and rewarding jobs; and community stability. **Popular knowledge of investment and economic development alternatives is strongly limited by the fact that these issues remain overwhelmingly private decisions, within the exclusive prerogative of company owners and management. Bipartite and tripartite sectoral initiatives are relatively undeveloped mainly because there is no obligation on employers to discuss or negotiate broad investment decisions with workers and unions.**

Labour involvement in investment decision making is also undercut by lack of access to information, a shortage of technical resources and lack of experience. Unions will not be in a position to develop sophisticated industrial development proposals in the absence of a process which develops the capacities of the movement. While many unions have research capabilities and are heavily involved in worker education, resources are very limited when compared to those of the labour movement in, for example, Germany and Sweden. In both of these countries, individual unions and labour centrals have large technical staffs which develop educational and other materials which are then used to educate and involve the membership in issues related to economic restructuring. Further, unions in these countries often have access to strategic management information.

The potential for an alternative approach is indicated by the experience of union involvement in investment decisions in Quebec. While union sponsorship of the fonds de solidarite has been controversial in the labour movement outside Quebec, there can be no doubt that it has assisted in the development of the capacities of the movement. The FTQ has direct access to expert staff involved in the evaluation of investment opportunities, and is in a position to discuss company level investment alternatives in a sophisticated way. Further, significant fund resources are directed to the education of union members in economic and investment issues.

The case for broadened labour participation in investment decision-making is twofold. First, workers through their unions should be more directly involved in such decisions so as to broaden the decision-making agenda to include a wider range of concerns - most importantly concerns over jobs, future jobs, and community stability. Second, participation should be broadened so as to develop the capacities of unions, to give the labour movement greater understanding of particular sectors, in terms of how they function and how they might be developed.

As these capacities increase, the scope for a wider investment decision making process could progressively expand.

There is also a need to significantly expand community involvement in investment decision making. Experience of investment for social purposes already exists in worker co-operatives, other sections of the co-operative movement, and in community development corporations which provide "seed capital" on a non profit maximizing basis to small community-based ventures. There are some very concrete success stories in terms of investments which have been made to save or create jobs and to develop community economies, rather than to maximize the rate of return on invested capital. The co-operative movement and community development corporations have also developed technical capacities. Unfortunately, worker co-ops and small community owned enterprises remain a tiny and marginal part of the total economy. The experience of the successful worker co-op sector in Spain and in Italy suggests that lack of access to large pools of capital in Canada is an important factor in this underdevelopment.

V: PULLING THE THREADS TOGETHER: THE NATIONAL INVESTMENT FUND

The arguments put forward in this paper which speak to the need for a National Investment Fund can be briefly summarized.

- There is a significant gap in Canadian capital markets which leads to under-investment in "soft assets" such as research and development, and which hinders the growth of small and innovative enterprises.
- The lack of close relationships between the financial and industrial sectors results in a higher than necessary cost of capital for Canadian industry, and in under-investment in projects requiring long-term commitments of "patient capital."
- These gaps in the capital market result in a significant loss of potential jobs.
- The existing private investment system leads to over-investment in some sectors, and highly speculative financial activities which waste capital. Some of these activities have significant harmful effects on the economy as a whole.
- The globalization of financial markets has led to large outflows of private capital from Canada, and has meant that investments in Canada must meet a threshold of providing an equivalent, risk adjusted, rate of return to investments in other countries.
- Investments based on private rates of return do not necessarily maximize rates of return for the economy as a whole. There are significant social returns which should be taken into account in investment decision-making.
- Access to capital is one important way of increasing the influence of labour and other groups in investment decision-making and of making sure that wider concerns are taken into account.
- Labour and community involvement in investment decision-making is one important way to build the capacities of popular movements.

These shortcomings can be responded to in a variety of ways, including through government regulation and direct government participation in investment decision-making, and through increasing labour's direct access to capital (eg. through joint control of pension funds, through labour sponsored venture funds etc.). **The proposal for a National Investment Fund is not meant to be the single answer to all of these shortcomings.**

A National Investment Fund would be designed to create a significant pool of capital which could then be invested on the basis of criteria other than maximization of the rate of return.

Given the waste and mis-allocation of resources by the private investment system, it is appropriate that the Fund be mainly financed by compulsory deposits on the part of major financial institutions (ie. banks, trust companies, insurance companies). These institutions could be required to deposit an initially small portion of their total available funds with the National Investment Fund, just as the banks formerly had to maintain reserve requirements with the Bank of Canada. The Fund would pay a modest (positive but below market) rate of interest on deposits. Over time, the portion of financial institution assets in the Fund could be increased.

Pension funds would not be required to make deposits with the National Investment Fund, but would be encouraged to deposit a small portion of their total available funds and thus to contribute to the Fund's objectives. The government could guarantee a minimum, market level rate of return on such deposits to ensure that benefits to plan members were not jeopardized. Credit Unions would also be encouraged to make deposits on a similar basis.

The Fund's Board of Directors would consist of representatives from the labour movement, other nationally organized popular movements, business and all levels of government. The Board would be served by its own technical staff.

At the national level, the Fund would function as an investment bank which would evaluate major investment proposals, and provide support either in the form of equity, or in the form of long-term, low interest loans. Over time, the Fund would accumulate a large revolving fund as returns from past investments became available for re-cycling. The Fund might choose to maintain equity positions for long periods of time, and to nominate representatives to corporate boards. The staff of the Fund would evaluate investment proposals, and staff resources would also be developed to provide expert financial and other advice to companies in which the Fund invested.

The Fund would seek to operate on a decentralized basis to respond to a wide range of investment needs. Separate bodies with a similar representation basis could be established in each province, leaving the national board to deal with large investments of broad national importance, and with the allocation of funds to subsidiary bodies.

A broad range of subsidiary funds, each with a semi autonomous board, should be established. These would include sectoral development banks, with a mandate to invest in particular sectors of the economy such as pulp and paper, auto parts, telecommunications and so on. Investment decisions would be made by board members drawn from both labour and business and by staff with a comprehensive knowledge of the sector and its development potential. Funds could be allocated to individual enterprises, and as start-up funds to sector wide institutions, such as joint technology and research and development centres which would generate their own revenues. Industrial development banks exist in a number of countries, including Japan, and have become effective in developing sectors not just through relatively low cost capital, but also through the accumulation and pooling of technical and other expertise. For example, a sector development bank would be in a position to see investment opportunities which might not be initially apparent to individual companies; could promote joint R and D projects which combined the capacities of several companies, etc..

Subsidiary funds should also be set up to support the development of worker co-operatives and community development corporations. Funds might also be established to invest in social housing projects, and to promote environmental investments.

The mandate of the Fund and subsidiary funds would be to invest for a positive rate of return while simultaneously attempting to meet a range of wider objectives - most importantly job preservation and creation, and the development of strategic industries and new industrial capacities. Fund managers would, because of the funding mechanism, be in a position to accept a positive but below market rate of return. This would permit a broader range of investments to be approved than those now made by funds which adopt social investment objectives but remain obliged to also seek a normal rate of return (eg. ethical investment funds, some pension plans). **The most important point is that some job creating investments which do not meet the rates of return now set by private investors and financial institutions could go forward.**

Since the Fund and its subsidiary bodies would be in a position to provide long-term equity and loans on favourable terms and conditions, they would be in a position to choose between a wide range of possible investment projects. An auto parts company planning an expansion of capacity would, for example, likely see the appropriate sectoral development bank

as a preferred source of outside financing. Because this would be the case, in practice the Fund would not necessarily have to accept a substantially below market rate of return.

While establishment of a National Investment Fund would undoubtedly be strongly opposed by financial institutions, some sectors of business might be persuaded to support the proposal. The Fund would, after all, be mandated to fill gaps in the capital market which have been identified by business, and to provide investment funds on a favourable basis. Also, the Fund would not be a "top down" government planning instrument, but would closely involve business organizations.

From a labour point of view, the establishment of a National Investment Fund and subsidiary funds would open up major new opportunities to influence investment decision-making. Because of labour participation on the national and subsidiary funds, including sector development banks, the labour movement would be in a position to strongly influence the allocation of relatively low cost, long-term capital. This in turn would likely result in initiatives by firms to involve labour in the firm-level investment decision-making process. Most importantly, the creation of sector level funds in which unions had strong representation would put the labour movement in a position to help develop and implement alternative sector wide strategies.

The concept of a National Investment Fund could also win support from the wide range of organizations and individuals who are concerned with community economic development. An earmarked source of funding for worker co-ops and small community enterprises and availability of technical expertise in support of such ventures could prompt many communities to more aggressively organize local economic development initiatives. As local involvement grew, capacities would grow and "bottom up" initiatives would become more common.

Over time, the establishment and working of a National Investment Fund and subsidiary funds could greatly broaden the whole investment process not just in terms of investment criteria, but also in terms of the range of interests represented and the voices which are heard. To the extent that it was successful, a National Investment Fund would build not just a healthier economy with higher levels of employment, but also a much more democratic economy.

VI: APPENDIX -

EXTRACT FROM C.L.C ECONOMIC POLICY STATEMENT

83. Our concept of an economy subject to democratic participation and control sees a role for worker co-ops and worker-owned enterprises, community-controlled development funds, worker or jointly controlled pension funds, and labour-controlled investment funds. All of these instruments can anchor mobile capital in a global economy and help direct investment to social objectives such as job creation and community stability which go beyond pure profit maximization. Unlike private capital, social investors can take a long-term perspective and can accept a rate of return on capital lower than the maximum that might be available elsewhere.
84. In a legislative and bargaining context, we should place particular priority upon the need for at least joint labour control of pension funds. The principle of labour control should extend to public sector pension funds. Unions which achieve greater control of pension fund investment should seek to broaden the range of criteria involved in investment decisions, consistent with securing an adequate rate of return.
85. The labour-sponsored Solidarity Fund in Quebec has become the largest venture capital fund in the country and plays a significant role in Quebec capital markets. While limited to minority ownership, the Fund has helped preserve and create jobs in Quebec-based enterprises. Similar funds are now being established or are under active consideration in other provinces. Different models of labour-sponsored social investment funds have been proposed within the trade union movement, and are also under consideration by some provincial governments. Pending federal legislation will allow individual unions to sponsor national venture capital funds. There is more limited progress and experience in terms of labour control of pension fund investments, but some unions in B.C. have used such funds to finance union-built construction projects serving wider social objectives. Finally, the worker buy-out of Algoma Steel has shown that worker-ownership of even large scale enterprises is a real possibility.

86. Direct labour involvement in the investment process through social investment funds and worker-ownership has the potential to increase our role in economic decision-making. We are still, however, at the stage of experimentation and must learn from initiatives which have just recently begun or are still being developed.
87. Interest in social investment should not divert attention from the need for greater social direction of private capital if we are to achieve our objectives. Proposals we put forward for economic renewal or for alternative forms of restructuring on an enterprise, sectoral or wider basis are unlikely to be implemented without capital to make them possible. We need to create pools of capital which can be drawn upon to finance proposals which would create jobs and help rebuild our productive base, but which are rejected by business because they are deemed too risky, or because the anticipated rate of return is too low relative to investment in other countries.
88. A National Investment Fund — which could in turn be divided into provincial, sectoral and community funds — should be established, with substantial labour participation in the direction of the Fund at least equal to that of business. The Fund could be financed through deposits from a number of possible sources. For example, the Fund could be based on some combination of the following: a) mandatory deposits by financial institutions; b) mandatory deposit of a portion of corporate profits; c) direct allocation of government funds; and d) deposits by pension funds. Rates of return to specific classes of depositors could be guaranteed by the federal government. The Fund, aided by technical staff, would be mandated to invest in projects which contributed to the growth of national productive capacity and economic renewal.
89. Of its nature, such a Fund could be established only after a long period of discussion, refinement of policy, and social bargaining. The key point would be to establish significant, centralized pools of capital which would be allocated in a large part on the basis of labour input, to finance initiatives generated by labour and others on a decentralized basis. The Fund would link the development of an overall alternative economic development strategy to individual workplaces, sectors and communities.