municipalservicesproject

BRIEFING NOTE No. 2 – MAY 2012

The Cupboard is Full:

Public Finance for Public Services in the Global South

Ronnie D. Lipschutz & Sarah T. Romano

We are constantly told that there is no money for badly needed public services around the world. But who said the cupboard was bare? There is ample evidence that large pools of public monies exist for investment in public infrastructure, with public pension funds and sovereign wealth funds being two examples. Currently, these funds are being directed toward large-scale, capital-intensive, high-return projects aimed primarily at well-off urban residents and the private sector. Lessons from the financial crisis show that such funds could actually realize greater long-term returns from investment in public service provision while avoiding the politically controversial and contradictory practice of using public sector funds to support privatization. We make the case for using public pension funds and sovereign wealth funds for socially responsible investments in the global South, in support of essential public services.

Across the world there are one to two billion people lacking access to basic services, primarily water and sanitation, electricity and health care. For 30 years, governments and international financial institutions have touted the 'privatization' of service delivery as the solution to these shortcomings, with disappointing results. Private providers have not been more efficient than their public counterparts and have largely failed to extend coverage to the neediest.

In the meantime, there has been a great deal of organizational and institutional experimentation in service delivery in the global South, suggesting that the 'public' approach is alive and well, thriving with community participation and constituting a real alternative to privatization. But a concerted funding effort will be needed to support public services.

Our cost estimate to bridge the global public services gap, including annual capital costs and operation and maintenance, is **US$75 billion per year**. Two potential untapped sources for funding are the large pools of capital in Public Pension Funds (PPFs) and Sovereign Wealth Funds (SWFs). The former are made up of regular contributions from public employers and employees, offering fixed pensions to members upon retirement. The latter have been created by governments to collect and invest revenues from natural resources (mostly oil and minerals), budget and trade surpluses, and other state income. Roughly 75% of SWFs are found in the global South, whereas the great majority of PPFs are in the North.

SWFs and PPFs collectively manage as much as **US$10 trillion** in assets, and are expected to grow substantially over the next decade. In the United States and Canada, PPFs alone control about $3 trillion in assets. They are regulated under public law and have fiduciary responsibilities to their members that require prudent investment and matching of assets to long-term liabilities. They invest heavily in the private sector to maximize returns for their clients, seeking a targeted return rate of around 7% annually. Yet the volatility and uncertainty of private markets was made evident during the financial crisis of 2008-09 and European debt crisis of 2011 when the value of PPF and SWF holdings plummeted, due mostly to declines in equity and real estate markets.

> "There is a strong case to be made that PPFs in particular should have responsibilities to publics beyond merely ensuring high returns, and that attention to broad social needs can be a 'win-win' strategy."

In search of more stable, long-term returns, a growing number of funds are putting capital into privately owned water and electricity companies, infrastructure operators and private health care firms. The Ontario Teachers' Pension Plan (OTPP), for example, owns three privatized Chilean water utilities, each of which provides more than 10% return on investment (due in part to government guarantees). In other words, PPFs and SWFs already invest in service provision to the public, albeit indirectly and through private corporations.

There has been mounting pressure to change fund investment strategies coming from plan members, governments, public sector unions and activists, in line with more general trends toward social responsibility. Corporations are increasingly called on to adopt policies that promote more progressive behaviour and fund managers are being asked to invest in enterprises deemed environmentally sustainable that provide specific benefits to particular places or people.

In reaction to these trends, a growing number of PPFs and SWFs have adopted policies and investment programs that pay attention to their broader impacts. Consequently, some funds now pursue shareholder activism by attending corporations' annual meetings – the California Public Employees' Retirement System (CalPERS) being a good example – and some unions with public pension plans are selectively targeting companies that engage in unfair labour practices. The funds themselves, however, are well-insulated from direct public pressure and are rarely judged on their own social responsibility merit. There is a strong case to be made that PPFs in particular should have responsibilities to their members beyond merely ensuring high returns, and that attention to broad social needs can be a 'win-win' strategy.

Indeed, even though returns on investment in public services are often lower than those in private equity in the near to medium-term (1-3 years), regulated public utilities tend to be more reliable sources of income growth over the longer term. Under appropriate conditions, PPFs and SWFs could actually realize greater long-term returns

TABLE 1:
Total costs of service provision, annual and 20 years (2010-2030)*

	Number of people lacking service	Estimated annual cost per capita	Total annual cost	Total 20-year cost
Water	884 million	$4.00	$3.52 billion	
Sanitation	2.6 billion	$5.00	$13 billion	
Electricity	1.5 billion	$20.00	$30 billion	
General primary care	1 billion	$27.00	$27 billion	
Total	—	—	$73,52 billion	$1.47 trillion

*Assumes interest on loans is internalized in annual cost.

Source: Calculations by authors.

TABLE 2:
Portion of fund assets invested in infrastructure (2010)

Fund	% in infrastructure	Value in US$
Canada Pension Plan Investment Board	4.7%	$6.4 billion
Government of Singapore Investment Corporation	3%	>$6 billion
Alaska Permanent Fund Corporation	3%	$1.1 billion
Abu Dhabi Investment Authority	1-5%	>$4-20 billion
Ontario Teachers' Pension Plan	7%	$7 billion
California Public Employees' Retirement System	1.5%	$3 billion

Source: Dimsen et al 2010, 17.

by investing in public service provision. Such a strategy could also avoid the politically controversial and contradictory practice of using public sector funds to support privatization.

Could PPFs and SWFs do well for their members *and* contribute to the social good?

If PPFs and SWFs were willing to invest as little as 1% of their assets in publicly-owned and operated infrastructure it could create an initial capitalization pool of up to $100 billion, a sufficiently large sum to make an immediate difference in the scale and quality of services in the global South, and help to leverage additional contributions from governments and development agencies. Financing could be channeled through one or more intermediary institutions, with the most appropriate probably being some type of public or non-governmental infrastructure development fund or bank, such as the California-based Infrastructure and Economic Development Bank (I-Bank).

Setting up a special development bank in partnership with public pension and sovereign wealth funds could help provide the resources required for desperately needed public service projects. An independent 'GapServe' bank – as we call it here – financed by fund deposits and fund-owned equity would offer loans for closely monitored projects, following explicit principles of equity, access and non-commodification of public services. GapServe could also provide long-term, low-interest financing, with the specific rate dependent on the income level of the public agency to be supported.

While such public infrastructure investments may not match the returns on more speculative investments that many funds are forced to make to cover their liability shortfalls, we calculate that they could meet a return benchmark of 5% over the longer term, comparable to 10-year returns from higher risk investments such as equity and real estate. If guaranteed by governments and international financial institutions, such longer term investments could meet fiduciary objectives.

To take action on these potential pools of public finance we recommend the following:

- Inform fund holders of the current investments and strategies of PPFs and SWFs.

- Make the financial and ethical case for funds to champion socially responsible investment in public services.

- Create a global coalition to pressure funds, governments, the UN and IFIs to commit to closing the financing gap and to allocate public funds for public services.

There are already cases of recent fund activism and pressure campaigns on socially responsible investing, and it is critical that such models be expanded and internationalized. The case for economically targeted investments in the global South can and should be made in the strongest possible terms.

This briefing note is based on in-depth research and analysis published as a longer Occasional Paper available at http://tinyurl.com/7sr544f

ABOUT THE AUTHORS

Ronnie D. Lipschutz is Professor of Politics and a member of the Sustainability Engineering and Ecological Design working group at the University of California, Santa Cruz. Lipschutz conducts research on a range of topics related to global political economy, global governance, global civil society and corporate social responsibility, and environmental politics, among others. He can be contacted at rlipsch@ucsc.edu.

Sarah T. Romano is a PhD candidate in the Department of Politics at the University of California, Santa Cruz. Her research centers upon questions of access to resources, water in particular, and the politics of participation surrounding resource governance. She can be contacted at sromano@ucsc.edu.

Acknowledgements

This paper would not have been possible without the efforts and contributions of Professor David McDonald, who commissioned, reviewed and edited it; as well as Greg Ruiters and Ben Fine who commented on an earlier draft and Madeleine Bélanger Dumontier who completed the copy-editing.

FURTHER READINGS

Bakker, K. 2008. The ambiguity of community: Debating alternatives to private-sector provision of urban water supply. *Water Alternatives* 1(2): 236-252.

Bayliss, K. and Fine, B. (Eds). 2008. *Whither the privatisation experiment? Electricity and water sector reform in Sub-Saharan Africa*. Basingstoke, UK: Palgrave MacMillan.

Brennan, B., Hack, B., Hoedeman, O., Kishimoto, S. and Terhorst, P. 2004. *Reclaiming public water! Participatory alternatives to privatization*. Amsterdam: Transnational Institute.

Hall, D. 2009. *Infrastructure, the crisis and pension funds*. PSIRU, Business School, University of Greenwich (December).

Hall, D. and Lobina, E. 2010. *The past, present and future of finance for investment in water systems*. PSIRU, Business School, University of Greenwich.

Hebb, T. 2008. *No small change: Pension funds and corporate engagement*. Ithaca, NY: ILR Press/Cornell University Press.

Larrain, S. and Schaeffer, S. (Eds). 2010. *Conflicts over water in Chile: Between human rights and market rules.* Santiago, Chile: Chile Sustentable.

McDonald, D.A. and Ruiters, G. 2012. *Alternatives to privatization: Public options for essential services in the global South.* New York: Routledge.

Spronk, S. 2010. Water and sanitation utilities in the global South: Re-centering `the debate on 'efficiency'. *Review of Radical Political Economics* 42(2): 156-174.

Warwick, H. and Cann, V. (Eds). 2007. *Going public – Southern solutions to the global water crisis*. London: World Development Movement.

ABOUT THE PROJECT

The Municipal Services Project (MSP) explores alternatives to the privatization and commercialization of service provision in the electricity, health, water and sanitation sectors. MSP studies progressive models deemed successful in an effort to understand the conditions required for their sustainability and reproducibility. The project is led by academics, NGO representatives, labour leaders and activists from different sectors and regions who believe in strong research for social change.