GETTING TO GROWTH

A few days ago I turned on CNN, there was Donald Trump leading a chant in South Carolina: “Build the wall”. “Build the wall”. Earlier, he called for a 45% tariff on China’s exports to the United States. Economists and financial commentators pounced on it. Bad economics. Counter-productive.

Yet on Tuesday, he won again – in seven states. Sadly appealing to the worst instincts of people.

Bernie Sanders wants to lead an economic revolution. He attacks the banks. He proposes to tax Wall Street to pay for a long list of pledges. The experts call it magical thinking.

But they’re still cheering. As one pundit said "he may be losing the nomination, but he’s winning the argument."

Today, it seems that the popularity of presidential candidates rests not on the soundness of their ideas but on their ability to give vent to frustration.

Especially the frustration of those in the middle class or those trying hard to join it. Who believe that their interests are no longer defended – or advanced – by traditional politicians and institutions. Who feel that while they might be able to change governments by voting, they can’t change politics.

A politics in which they think big money funds special interests. But not their interests.

Both Trump and Sanders have captured that zeitgeist – widespread political distrust rooted in a profound sense of economic insecurity. An insecurity felt by too many people in too many countries. Including Canada.

A recent study by the Institute for Research on Public Policy points out that between 1982 and 2010, incomes for the bottom 90 per cent of Canadians grew by two per cent, but by 160 per cent for the top 0.01 per cent. An astonishing disparity.

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Little wonder, then, that all federal parties made the middle class the focus of their platforms in the last Canadian election.

And little wonder that there are widespread demands for political change on both sides of the Atlantic and growing dissatisfaction with our economic institutions.

Why so much frustration and distrust?

There’s a lot at work here. Including trends that are positive in the long run – but that present real challenges in the short run.

Technological change – that is profoundly altering how things get made – and what gets made.

Globalization – that is changing where things get made. And separating where they get made from where they’re consumed.

And, of course, part of the frustration is rooted in our financial system – a system that is seen by an increasingly restive public as disconnected from the real concerns of real people in the real economy.

At one time, our financial system acted as a circulatory system, allowing money, credit and capital to flow freely - supporting investment, trade and growth. But over the last 30 years, it’s evolved into a closed loop – an end in itself.

Under the guise of financial innovation, we engineered complex, often opaque financial instruments that were essentially designed for the financial markets and understood by very few.

In the past, our creative energies were directed towards big innovations – electrification, mass production, pharmaceuticals, today, the internet – they’ve all delivered enormous, widely shared public benefits. But recently, too much of our creative efforts have beenfocused on financial innovation that has only benefitted the few. Unlike before, it just hasn’t translated into gains for the average citizen.

In fact, quite the opposite. When the financial system froze in 2008, those heavily engineered

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financial products brought down the real economy too. Throwing us all into uncharted territory. People lost jobs. Lost homes. In Europe, a generation of young people lost hope. No mystery why a sense of grievance is so widespread.

To their credit, central banks, led by the Federal Reserve Board, acted quickly. Innovating until they found creative solutions to inject liquidity through emergency tools like asset purchases.

In addition, in October of 2008, for the first time, six major central banks acted in concert, simultaneously cutting interest rates.

These early efforts paid off. Credit markets thawed. Long bond rates came down. Over time, the actions of central banks helped bring the recession to an end in most major economies around the world.

So, in the face of the crisis, the central banks did their job. Thinking differently to find new ways to confront a new situation. But here's the rub. These actions were never intended as a long-term solution. They were meant to buy time for governments to act to stimulate growth and expand the productive potential of their economies.

Unfortunately, this just hasn't happened. Certainly not enough to promote strong, sustainable growth in the face of slowing labour productivity, decaying infrastructure and, in developed markets, an aging labour force.

The result? Chronically low global growth that, according to the OECD, is expected to be about 3 per cent in 2016, with weaknesses in both the developed and emerging economies.

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Well, you may say, three per cent sounds pretty good. It isn't. Only a few years ago the International Monetary Fund considered anything below 4.0 per cent global growth as weak. Three per cent? That was the land of recession.

Even in the United States, a relative bright spot, growth is expected to be around 2.0 per cent or less. This has obvious implications for Canadian manufacturers and exporters looking to a U.S. recovery to stimulate our economy, which is likely to grow at less than 1.5 per cent.

What does all that mean for people and for their ability to better their lives? Just this. When economic growth in developed countries averages three per cent, it takes 24 years – less than a working lifetime – for them to double their standard of living. At 1.5 per cent, it takes 47 years, twice the time.

Is monetary policy going to save us again, and get us out of this chronic slow growth? In a word, no! As the policies of central banks – both conventional and non-conventional – have been repeated over and over they've hit the law of diminishing returns. Today, we're essentially pushing on a string.

When interest rates are already so low, reducing them again by a fraction of a point won't move the needle. In fact, it may even be counterproductive. People saving for retirement increase their rate of saving to make up for low returns, decreasing consumption. Businesses borrow not to expand their operations, but to buy back shares.

It's time to stop being fixated on monetary policy.

So what to do? How do we create an environment in which people feel confident enough to spend and businesses feel confident enough to invest? More simply: how do we generate economic growth in these unprecedented times?

We need to think differently. Find better ways. New ways.

Governments need to step up. Creating the conditions that will bring the private sector in from the sidelines.

That means putting growth at the center of their priorities: both to bolster the level of domestic demand, and increase the productive capacity of their economies.

In Europe and in most emerging economies, this means structural reforms to make labour, financial and product markets all work better.

In North America, in contrast, it means getting focussed on post-secondary education, entrepreneurship, innovation and infrastructure – the things that build productivity and strengthen a nation's capacity to supply global goods and services.

And everywhere – in virtually every country – it means launching these actions in conjunction with accommodative monetary policy and fiscal stimulus: the only environment that will enable them to work.

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This is not about undisciplined spending or advocating chronic deficits. Although frankly? Given the magnitude of the issues we're facing and the uncharted waters we're navigating, it's possible to overstate the value of balanced budgets in today's circumstances.

As Larry Summers recently wrote in Foreign Affairs, "…many worry that running larger deficits would place larger burdens on later generations…But those future generations will be better off owing lots of money on long-term bonds at low rates in a currency they can print than they would be inheriting a vast deferred maintenance liability."

He was talking about deferred investments in public infrastructure, but the central point holds: deficits incurred in investing in the right things at the right time, beat balanced budgets that fail to invest in generating growth.

That being said structural deficits do matter. Governments can't do it all by themselves. The fiscal constraints they face are real and in many cases, growing. The good news is that they don't have to do it alone.

There are financial institutions, like pension plans and many sovereign wealth funds - long-term investors – who oversee about $40 trillion worldwide. That's an enormous pool of capital with a tremendous potential to drive growth.

Now let me be clear. Crystal clear. These institutions, particularly pension funds, should not be, cannot be, must never be, arms of the state. They are not instruments of policy. They must have the independence they need to make the investments they choose. Where and how they see fit. Period. Full stop.

But the facts are plain. For all institutional investors across the world, the world has changed. Over the past 5 years, annual returns from world stocks averaged around 10 per cent. Over the next 5 years, they're expected to deliver 5-6 per cent. Fixed income, same story. From 5 per cent to say 1-2 per cent. The party's over. The traditional engines of investment returns are just not going to deliver as they once did. So the time has come to think differently – to find new investment strategies capable of delivering the returns that institutional investors require to meet the needs of the people we serve.

My point is this: precisely because the world of investment returns has changed so dramatically, today there is a natural co-incidence of interest between the independent financial mission of institutional investors and the investment needs of the real economy.

Case in point: infrastructure. It's what ties an economy together. The systems that make an economy work. Connecting people to jobs, through public transportation. To information, through broadband. To markets, through ports, roads and airports. Infrastructure drives productivity. It makes economies more competitive.

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But not just that. Infrastructure stimulates economic activity. It bolsters demand, something every country needs today. According to the IMF, every dollar invested in new infrastructure creates $1.40 in new economic activity. $100 billion spent on new infrastructure can create 800,000 new jobs.

For long term investors, infrastructure offers something that's not easy to find today: stable, predictable returns in the 7 to 9 per cent range with a low risk of capital loss– exactly what we need to meet our clients' long term needs.

At the same time, these investments address a pressing global need for infrastructure - estimated at $57 trillion over the next 20 years. That's about 60 per cent more than was spent over the past 20 years.

In the United States, the American Society of Civil Engineers has given that country's infrastructure a grade of D+. Requiring an investment of $3.6 trillion in overdue maintenance and modernization by 2020.

At la Caisse, we've invested about $13 billion in infrastructure around the world. From wind mills in the North Sea to the Port of Brisbane in Australia to Vancouver's Canada Line here at home.

And we're aiming to double our infrastructure portfolio within four years.

We've also been giving a lot of thought to the best ways to finance infrastructure and we've created a model that we think holds interesting potential.

It's based on a simple idea: to use pension money from people to fund projects for people that will make life better for people. It's a public-public model, not a public-private partnership.

We propose to oversee commercially-viable projects from start to finish – everything from planning to finance, construction to operation. In other words, a one-stop shop with end-to-end management.

This new public-public partnership model allows governments to act as the guardian of the public interest but transfers the execution and financial risk to us.

To manage those risks, we have created an operating subsidiary staffed with engineers and project management specialists. This subsidiary will in turn, use a best practice competitive process to select the right partners to carry out the work.

In the end, we own the assets and the project never touches a government balance sheet – a significant difference from typical public private partnerships.

For governments all around the world, this could substantially change how major infrastructure projects get financed by providing a solution to their fiscal constraints. For la Caisse, it gives us the opportunity to create more value through a deep knowledge of operations and a capacity to control execution.

We're just getting started with two projects in Montreal. We know this model is new – certainly a new role for a pension fund. And, frankly, that's why we like it. We're convinced it will be an important source of competitive advantage in the years ahead. So far, we're encouraged by the interest we are receiving in the United States and Europe.

❮❮ These projects pay us double digit returns – not easy to come-by today. They are also acting as a platform for significant future gains as clean technologies take off. And become powerful engines of economic growth, to say nothing of helping meet the COP 21 goals. ❯❯

It's just one idea. Just a start to thinking differently about how the interests of long-term investors and the needs of the real economy can converge to be mutually reinforcing.
There is no shortage of other examples.

More and more, when we invest in Canadian companies, we work with them, as they expand into foreign markets. Using our global network of relationships to connect them to opportunities. Opening doors – and markets.

As a shareholder, we do this to enhance returns – to outperform markets. But, of course, as we work with them, these companies also expand Canadian exports– and that's never been more important for domestic growth.

Another area where we see a co-incidence of interest: climate change, one of the defining issues of our time. At la Caisse, we've invested $13 billion in renewable energy, electrified transit and LEED certified buildings. We're North America's largest pension fund investor in wind power.

For us, the reasoning is simple. These projects pay us double digit returns – not easy to come-by today. They are also acting as a platform for significant future gains as clean technologies take off. And become powerful engines of economic growth, to say nothing of helping meet the COP 21 goals. As the UN Secretary General once famously said, there is no Planet B.

Infrastructure, exports, climate change: just a few areas where the interests of a different kind of financial institution – long-term investors – are co-incident with the imperatives of economies struggling to generate growth.

New opportunities. To invest in new and renewed infrastructure. In innovation. In greener ways to generate growth. Moving away from a fixation with financial markets to focus on the real economy.

Investing in real things that actually make the real economy work better for people.

Yes, we live in turbulent times. But the solutions to generating economic growth won't come from high-voltage bombast or utopian visions. They won't come from some new financial instrument that only someone with a PhD in math can understand. They will come from building the engines of growth in the real economy.

By investing in those, perhaps we can reduce the corrosive disenfranchisement of the middle class that we see playing out on our T.V. screens every night. And displace this distemper with a greater optimism about our future.

Speech delivered by Michael Sabia to the Toronto Region Board of trade on March 3, 2016