

Jul 8, 2005- Buzz Hargrove's Counterpoint

From The National Post

Recent news reports have drawn attention to financial and governance problems at Manitoba's Crocus Investment Fund -- that province's "labour-sponsored" venture capital fund. Late last year, the fund halted trading in its units. In May, Manitoba's Auditor- General released a damning report on management practices.

Last month, the board acknowledged the fund could not return to market. It estimated the value of units at \$7 - less than half their July, 2000, peak and more than 30% below their value when trading was halted. The new board chairman, Van Hall, couldn't have been more bleak: "The high net operating cost, poor investment performance, threat of litigation and other factors make it irresponsible for the board to ask Manitobans to invest in the fund at this time." Now the commercial crime unit of the RCMP is considering whether criminal charges are warranted.

The difficulties at Crocus are certainly the most dramatic example of the failure of labour-sponsored funds to become economically viable, but they are not the only example. There are about 120 labour-sponsored funds in Canada. Two-thirds of them lost money over the last year (even as the TSX composite was gaining more than 20%). None of the 10 largest labour funds has generated a positive return over the past five years.

Labour funds have been criticized for extremely high management fees (typically twice as high as normal mutual funds), lack of transparency and liquidity, and hoarding a large proportion (in many cases more than half) of their assets in cash or treasury bills. These fundamental economic flaws now seem to be catching up with the entire industry. Every investor knows the stock market has its ups and downs. Most labour funds, however, only have the downs.

So why does anyone invest in these vehicles? One reason, and one reason alone: a lucrative subsidy from taxpayers. Federal and provincial credits offset 30% of a labour fund investment. Throw in the value of the RRSP deduction and investors can pay as little as 25 cents on the dollar for their stake.

In the short-run, this makes them rather appealing. In fact, bizarrely, switching existing RRSP assets from a normal mutual fund into a labour fund can actually be a way to raise quick cash at tax time -- say, to fix your roof, or take that Caribbean cruise. You get 30% back for money you've already saved.

There's only one catch: You have to leave the money there for eight years, or else pay the 30% back. And returns on the labour funds have been so dismal that even that subsidy stops looking so good. Consider the First Ontario fund, for example, units of which are 8% lower than five years ago. Investing the same money in T- bills for the same period would have generated a compound return of more than 25% (compared with the loss of 8% that was incurred). Even a 30% subsidy can't offset that disadvantage.

It may seem strange for a labour leader to criticize an industry that is supposedly sponsored by labour. In fact, however, these funds do not reflect the values or, in most cases, even the oversight of the labour movement. Most investors are not union members; they are regular profit-hungry investors who thought they were getting a good deal. And most of the funds are not run by unions; they are labour-sponsored in name only, by unions that "rent" their logo to financial

wheelers and dealers. Even those with a more genuine union connection (such as the Crocus and First Ontario funds) are in trouble.

The CAW has never supported the labour fund concept. We've argued they are a waste not only of taxpayers' dollars but also of the hard-earned credibility of the unions that "sponsor" them. Now these unions have to explain to their investors why they've lost so much money. Should that be a major focus of a union's attention and energy? I don't think so. Unions operate in a hostile economic and political environment. We need to devote all our creativity and attention to doing what unions were invented to do: organizing members and winning a better deal for them in their workplaces, and in society.

I strongly support efforts by government to stimulate more investment spending in Canada's economy. Business investment levels are very disappointing, especially compared with the dramatic run-up in corporate profits generated here. But labour funds are not the way to do it. They are wasteful, ineffective and damaging to the integrity of those unions that have involved themselves in them.

In Quebec, unions have been especially supportive of their labour-sponsored fund -- the Solidarity Fund -- which aims to strengthen the provincial economy in line with the labour movement's vision of an independent Quebec. I won't judge their autonomous decisions in that regard. In English Canada, however, the labour funds have been a disaster -- financially for their investors and politically for their sponsors.

Union members should steer clear of them. And policy-makers should start to rethink the lucrative subsidies that are the only reason for this strange industry's existence.