CANADIAN CENTRE FOR ECONOMIC ANALYSIS

Toronto, Ontario, Canada
Office: 1-416-782-7475
Fax: 1-888-382-4686
Email: connect@cancea.ca
Web: www.cancea.ca

Ontario Infrastructure Investment: Underinvestment Trend Continues

An independent research update prepared for the Residential and Civil Construction Alliance of Ontario.

INVESTMENTS IN ONTARIO INFRASTRUCTURE OVER THE LAST 10 YEARS

After Ontario's latest budget announcement, it is an important time to assess whether the proposed level of infrastructure investment sets Ontario on track for long-term economic growth. Historically, investments into Ontario's public infrastructure have been significantly lower than the growth-maximizing target levels suggested by CANCEA's 2010 econometric analysis. (Econometric models use statistical techniques to study relationships between economic variables, such as between GDP and infrastructure investment, and to produce forecasts.)

CANCEA reported that there was a gap in infrastructure investment in a 2010 report called "Public Infrastructure Underinvestment: The Risk to Canada's Economic Growth"[1]. The analysis quantified the associated significant economic risks to workers, business and long-term GDP growth. The investment situation of 2010 put Ontario on a risky slope, whereby small decreases in investment could have a negative impact on future GDP growth.

Subsequent updates to the study (2011, 2014, 2015, 2016 and 2018, all commissioned by the Residential and Civil Construction Alliance of Ontario, or RCCAO) demonstrated persistent underinvestment, effectively pushing Ontario further down the risk slope and away from the level required to maximize long-term GDP growth. While the dollar value of infrastructure investment grew by 11% between 2011 and 2018, investments as a percentage of Ontario's GDP decreased from 3.25% to 2.79% – a 14.2% drop in this key measure. This indicates that infrastructure investment is not keeping pace with economic growth. These levels are well below the 3.5% of GDP anticipated in the 2011 report based on the announcement of Ontario's 10-year "Building Together" plan.

[1]https://www.cancea.ca/cancea/reports/47/public-infrastructure-underinvestment-risk-canadas-economic-growth

As a result of this continual decrease in investment relative to GDP, the target level – the level at which long-term real GDP growth is maximized, which is determined through econometric modelling – was revised from 5.1% in 2011 to 5.4% based on the 2018 update report (combined Ontario/municipal, plus federal investment in the province).

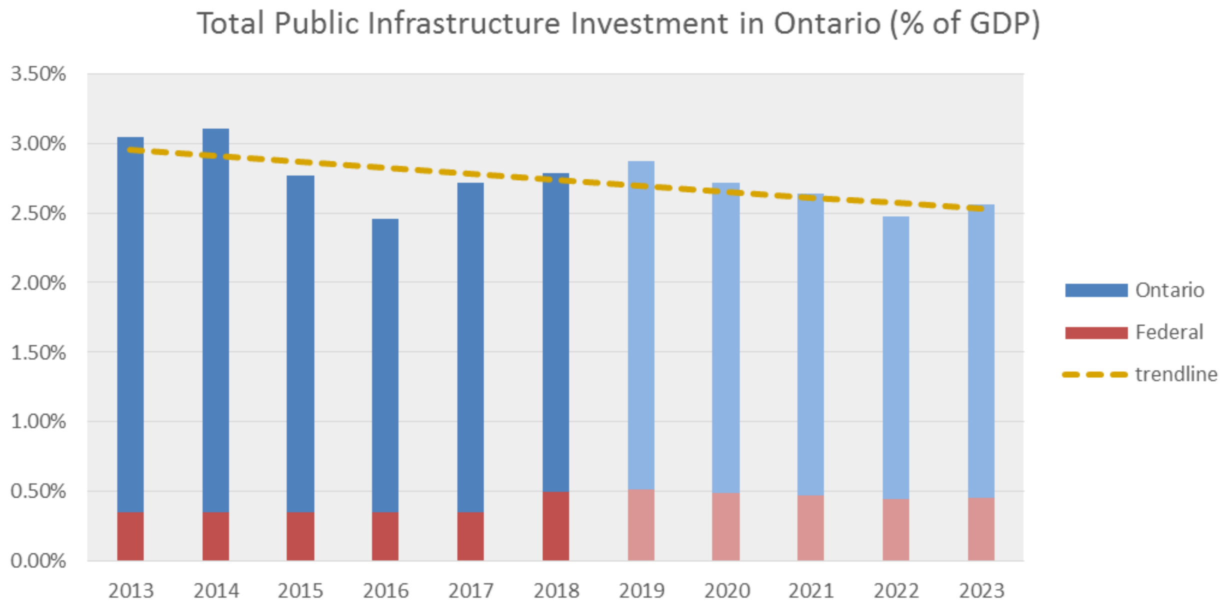
These studies also found the share of infrastructure investments borne by the federal, provincial and municipal governments to be unfairly allocated. The federal government is a significant net beneficiary, receiving a larger share of the benefit from the infrastructure investments made in Ontario than the share it directly invested. In the years since the initial study, we found that the federal government remains significantly underinvested, at 25% of what benefit analysis suggests. This leaves the province in a precarious situation, as any increases in investments relative to provincial GDP would have to be financed using debt, which can pose a structural risk of deficit. However, choosing to reduce the amount invested would cause greater long-term economic risk.

2019 Update: Budget indications show continued downward trend

This update uses the recent budget announcements from the federal and provincial governments to track these trends. The combined annual dollar value of infrastructure investments is expected to decrease from 2019 to 2022. This translates into a continued downward trend in the percentage of provincial GDP invested annually (-0.04 percentage points per year, on average), as depicted in Figure 1 below. Given these recent numbers, investments are expected to be near the 10-year low of 2.45% seen in 2016 again by 2022.

This indicates a continuing historical trend of growing economic underinvestment. The expected total investment over the next five years is 2.65% of provincial GDP – less than half the target investment (5.4%) for long-term growth – leaving an investment gap of 2.75% of provincial GDP.

Figure 1 Total Public Infrastructure Investment in Ontario by Year



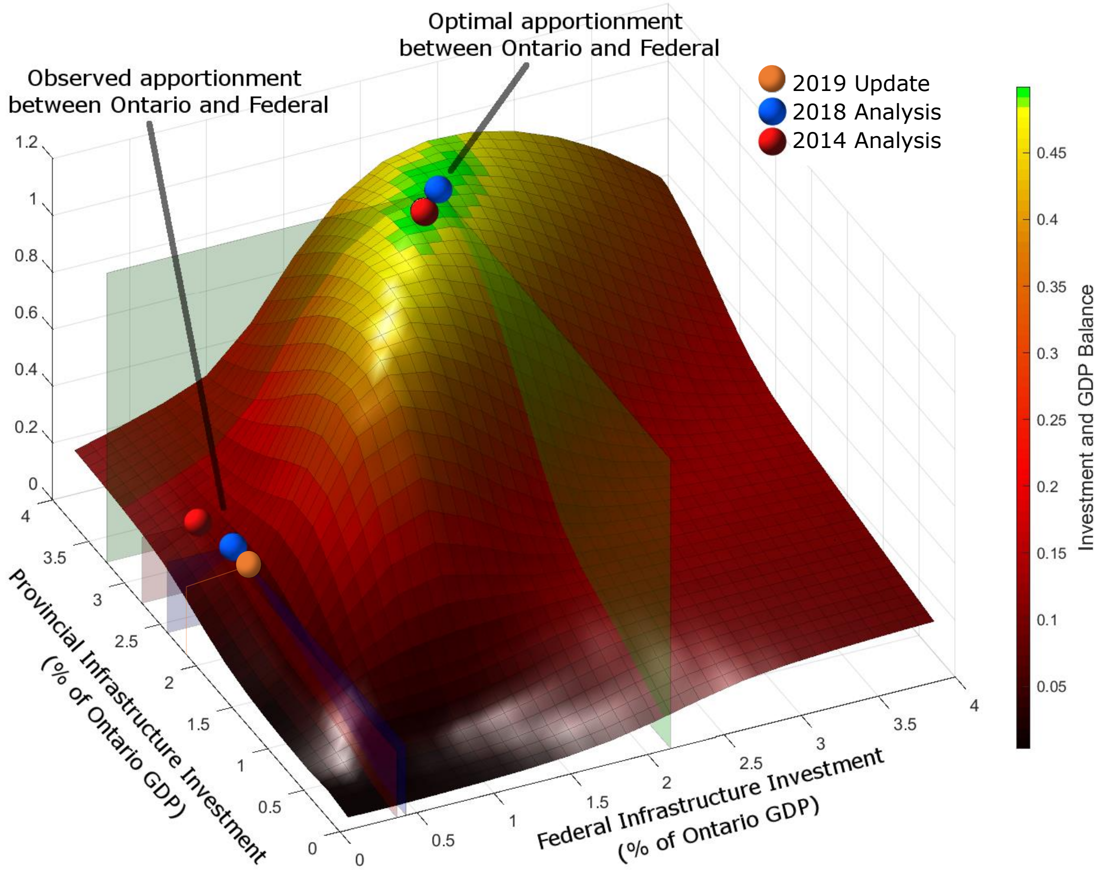
IMPLICATIONS

The combined infrastructure investments in the 2019 budgets represent a further move away from the econometric target levels for long-term growth. The growing investment gap is plotted on Figure 2. The current investment level has shifted further away from the sustainable allocation, as represented by the orange dot in the figure. The shift can be attributed to a decrease in investment relative to GDP from the provincial government, since federal investments as a percentage of GDP have remained relatively constant over time. Nonetheless, the federal government's share has remained significantly and structurally low, at a quarter of what it could be[2] (see green marker in Figure 2 for target level).

The growing investment gap presents a long-term challenge. As both levels of government continue to underinvest relative to the optimal levels, making up the difference will require an increasingly large investment relative to provincial GDP in the future. Public infrastructure is a long-term investment, and sub-optimal investment decisions made today will continue to have negative economic implications in the years to come.

[2] https://www.cancea.ca/cancea/reports/45/ontario-infrastructure-investment-federal-and-provincial-risks-and-rewards

Figure 2 Comparison of Optimal and Actual Investment Levels, Provincial and Federal



CONCLUSION

Systematic infrastructure underinvestment by the federal, provincial and municipal governments poses significant risk to Ontario's economy. Given the importance of public infrastructure, a continuation of this trend will mean projects that provide fundamental support to Ontario's growing economy will have to be delayed or perhaps cancelled. Ratcheting up the percentage of GDP spent on infrastructure sustainably requires a collaborative effort between all levels of government. To be sustainable, the investment should be apportioned between different tiers of government according to expected future benefit.

CONTACT

Canadian Centre for Economic Analysis

416-782-7475

connect@cancea.ca