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UPGRADING CANADA'S AGING INFRASTRUCTURE WILL REQUIRE A NEW APPROACH, SAY TD ECONOMISTS

TORONTO – In a comprehensive report released today, TD Economics calls on policymakers to take bold actions to upgrade Canada's system of public transit, roads, water, sewers and other public assets. Entitled *Mind the Gap: Finding the Money to Upgrade Canada's Aging Infrastructure* and available online at www.td.com/economics, the study represents the fifth in a series of TD Economics reports that address the challenges facing Canada's urban areas.

One of the greatest risks facing Canada's quality of life

Although the negative impacts of inadequate public infrastructure are only starting to become visible to Canadians on a day-to-day basis, they will soon mount. "We believe neglect of the country's stock of public capital is one of the greatest risks facing the country's quality of life," said Don Drummond, Senior Vice President and Chief Economist, TD Bank Financial Group. "With the state of a region's infrastructure weighing more heavily on location decisions of mobile businesses and individuals, a deteriorating capital stock will cut into productivity and living standards." Drummond added that the economy is only part of the picture. "Without a top-notch infrastructure, it will become difficult to ensure the health, safety and security of the nation's citizens."

As much as $125 billion investment shortfall

In response to calls to reinvest in Canada's weakened infrastructure, governments at all levels have ramped up their capital spending over the past 4-5 years. But, Drummond argued, "The new investments have only put a modest dent in a problem that has been allowed to accumulate over two decades." Measuring the dollar value of Canada's backlog of deferred maintenance, rehabilitation, and replacement of public assets (the so-called infrastructure gap) is no easy task, but the consensus among researchers is that it currently stands between $60 billion and $120 billion. Of that amount, at least half is recorded at the municipal level. “To put some context around it, the amount of the gap is roughly 6-10 times annual Canadian investment in public infrastructure.”

Finding the money

While the exact cost required to bring Canada’s infrastructure up to scratch and to support future growth is hotly being debated, one thing is for sure – the figure exceeds what most governments can viably foot under the status-quo. “To combat a challenge of this magnitude, governments at all levels are going to have to open the door more widely to approaches that will both relieve pressures on the public treasury and protect the high quality of public services.”

With an aim to raise efficiency, equity and accountability within the overall system, TD Economists identify a four-part strategy:

1) Further tilt towards a user-pay model

The government revenue mix should be re-balanced towards consumption-based levies, notably user fees. “While Canada is home to among the highest income and property taxes in the world, there is generally little effort made to align the price of services toward the full marginal cost of delivery.” Drummond acknowledges that while user fees are the most efficient revenue generator, they are also regressive in nature. However, there are a number of areas where there is no over-riding equity issue and where consumption can be easily monitored and measured. “Roads, bridges, water, sewers, electricity, and garbage collection offer particular potential for increased use of full-cost pricing.”

2) Give cities the right equipment for the job

Municipal governments – the number one infrastructure provider among the three orders of government – face a particular challenge in upgrading their infrastructure. Drummond notes that municipalities’ challenges have been exacerbated by inefficient use of their existing, albeit limited tools and powers. In addition to not charging full cost for services, the list of municipal shortcomings includes not making optimal use of debt financing. “Maintaining a low debt burden may be a laudable goal, but if it comes at the cost of foregoing or delaying capital projects because non-debt sources of financing are not available, then a low-debt strategy is counter-productive.”

Drummond adds that better use of funding vehicles currently at the disposal of municipalities would only go so far in providing municipalities with adequate resource to effectively fulfill their needs. “The issue is that local governments require access to a broader array of funding tools, such as access to a gasoline tax that would piggyback off the provincial base and whereby the municipality would set the rate.” He also notes that U.S. municipalities also have at their fingertips a number of other types of innovative instruments that deserve consideration. “None of the U.S.-style instruments, including tax-increment financing and enterprise zones, are magic bullets, but they may prove useful to Canadian municipalities on a case-by-case basis.”

3) Bring the private sector on board

With the demand for public infrastructure outstripping governments’ ability to finance and maintain capital projects, there is an increasing need to engage the private sector in infrastructure provision. “Probably the largest roadblock to more widespread use of public-private partnerships (P3s) is the country’s relative inexperience in using these more sophisticated arrangements and the resulting lack of public understanding.” As an example, he points to one common misperception. “P3s are believed to be little different than privatization, when in actuality, the government retains ownership of the asset and continues to establish the ground rules.”

However, Drummond acknowledges that P3s can be a risky game if not executed correctly. “Part of Canada’s difficulties in allowing the P3 market to get off the ground is rooted in a piece-meal approach to government policy. We should take a page from the U.K. book, where the government acted early to establish a standardized framework for P3s that, for example, helped to bridge the gap in expertise between the public and private sectors.”

4) The federal government needs to a bigger player

This nation-wide challenge requires the federal government to take on the role as quarterback. As a first step, however, the federal government should address issues in its own jurisdiction. "Although infrastructure largely falls on the doorstep of the local and provincial governments, more federal emphasis on issues in its own backyard is crucial in raising the number of skilled graduates, lifting prosperity and ultimately relieving fiscal pressures on municipalities." In particular, there is unfinished business in improving border infrastructure, aligning immigration settlement funds to areas where the costs are being incurred, and lowering lofty marginal personal tax rates applied to low-income individuals as federal tax benefits are steeply clawed back.

Still, the government will also need to pony up additional resources to help municipalities cope with their infrastructure challenges. At the same time, Drummond would like to see the government improve its decision-making process. "We support the creation of an independent board to provide advice to the government on what type of infrastructure should be financed and how." He envisions the advisory group to be made up of local and provincial government officials, as well as leaders from the private sector. TD Economics recommends that the federal government retain accountability through Parliament for funding decisions.

Come together (right now) over infrastructure

Drummond says that his recommendation for a newly-established advisory board encapsulates the importance of bringing the various players together under one roof. "If we can coordinate the policies and goals across the three levels of government, and add to the equation the expertise and deep pockets of the private sector, our chances of addressing the infrastructure challenge will improve ten-fold."

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This report, "Mind the Gap: Finding the Money to Upgrade Canada's Aging Infrastructure " (including charts) is available in PDF format on TD Economics' Home Page at: http://www.td.com/economics.