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Topic Paper

May 24, 2005

A PUBLIC-PRIVATE FIX:

Ontario's $100B Infrastucture Needs Are Too Rich For The Public Purse

This article appeared in the National Post on Friday, May 20th, 2005

We applaud the Ontario Government for opening the door more widely in its May 11th Budget to private-sector involvement in public infrastructure. All parts of the province's infrastructure are in a state of disrepair. Yet, unlike many of their international counterparts, political leaders in Ontario have been slow to accept that these investment needs – roughly $100 billion at last count and growing – cannot be addressed through public money alone.

The importance of engaging the private sector is very clear from the budget's figures. The announced infrastructure plan of $30 billion over five years was met with considerable fanfare and indeed sounds impressive. Yet, when the figure is broken down to an annual basis and by sector, it is apparent that the plan will make little dent in the infrastructure gap. Granted the Province supports public infrastructure through a number of vehicles on the operating side, such as the elementary school pupil accommodation grant and the share of the provincial gas tax provided to municipalities. But the Government's own net capital budget is projected to decline from $2.9 billion last year to $2.1 billion by 2007-08.

The plan contemplates five-year cumulative private sector funding of only $2.3 billion, or less than 10 per cent of the total. That seems realistic given the lead times required for new projects. The private sector involvement will, however, need to rise substantially in subsequent plans.

We also welcome the announcement that any proceeds from asset sales will be directed to incremental infrastructure financing. Equally encouraging is the indication that the cost of more projects will be spread over the life of the asset. The previous convention of charging the full cost of a project at its inception represented an obstacle to infrastructure funding and distorted the relationship between the fiscal position and the services Ontario residents reaped from capital outlays.

Private sector funding is needed for public infrastructure because governments simply have not been able to allocate sufficient funds to keep up with the needs. In Ontario, as in most Canadian jurisdictions, one of the reasons is that a rising share of revenues is being allocated to healthcare costs. Furthermore, with about 12 cents of each Ontario revenue dollar being directed at servicing the province's lofty debt load, infrastructure has been losing out.

There might have been a time when a pro-business perspective boiled down to a simple assertion that any government spending is wasteful and tax cuts are the unique key to higher productivity. That view has been replaced with concurrence that investments in areas such as education and infrastructure are a key ingredient to a successful economy and improving quality of life. Some examples illustrate how the infrastructure gap is dragging down the economy. The Ontario Chamber of Commerce estimates the annual loss from backlogs at Canada-U.S. border crossings at about $8.3 billion per year. The cost of delays in shipping goods in the GTA has been found to be $2 billion. Business also recognizes that public infrastructure cuts their costs. Indeed, Statistics Canada found that a one-dollar increase in the net public capital stock generates approximately 17 cents in average private-sector cost savings.

Addressing the infrastructure gap is not just about securing more funding. We have argued that bringing the price of services more in line with the cost of infrastructure delivery would limit waste and inefficiency. Moreover, since much of the infrastructure need now falls on the doorstep of municipalities, providing them with new tools to deal with challenges before them is also crucial. Above all, seeking the assistance of the private sector provides significant opportunities to close the infrastructure gap.

The private sector involvement should include project design, construction and operations as well as financing. Tapping private sector involvement across this broad range will be the job of the Ontario Infrastructure Projects Corporation (OIPC), an independent agency announced by Public Infrastructure Renewal Minister David Caplan.

A number of misperceptions concerning public-private-partnerships (P3s) have held back the use of private funding. For one, P3s are not privatization. Privatization refers to the outright selling of a public asset or service to the private sector. In contrast, the government retains control of the asset and continues to establish the ground rules in a P3 arrangement. Hence, there is no loss of public control. The Ontario government has indicated that in the case of hospitals, schools and water, they will retain public ownership. A number of articles have described this as precluding any private sector involvement in infrastructure in these areas. This is incorrect. The door is being opened to private sector participation in funding, design and operations.

The second myth is that P3s are inherently more expensive than traditional public procurement. The typical arguments are that governments can borrow at a cheaper rate and the private sector must strive for a profit. The arguments ignore the fact that public infrastructure projects in Ontario have been plagued by cost over-runs. They fail to take into account the opportunity cost of using public funds – such as higher taxes, higher debt, risk of rating downgrades and missed investment opportunities in other areas. The profit argument ignores the fact that almost any P3 arrangement transfers a degree of risk to the private operator for which some compensation must be expected. But, most importantly, it is not the cost, but the *net benefit*, which is the most relevant benchmark. And, in this regard, P3s can provide significant bang for the buck by allowing projects to be carried out more quickly and with greater overall benefits to the taxpayer.

For the P3 market to truly get off the ground the warmer public-sector receptiveness must be matched by considerable private-sector interest. The money is certainly there. The large Canadian pension funds are armed with a whopping $800 billion in invested assets. Indeed, pension funds have already indicated an interest in investing in infrastructure. However, given the lack of opportunities in Canada, some of the funds have been forced to look offshore.

The experience with P3s in Ontario and across the country has been rocky. This is not because the concept is flawed. Rather, contracts have been badly designed, with the risks and rewards improperly measured and aligned. At the first sign of controversy, many of the provincial governments have pulled back from the P3s rather than addressing the issues.

Experience elsewhere, such as in the United Kingdom and Australia offers a better way forward. The United Kingdom boasts more than 650 P3 projects in virtually every public sector. The contracts are clear and contain tough penalties against the private sector if they fall behind on construction or do not meet service standards.

As Ontario embraces more private sector involvement in public capital there will undoubtedly be challenges. Not least of these will be private sector trepidation over the Ontario Government's weak record in handling previous joint private-public infrastructure ventures. Such challenges must be overcome because the alternative is so unattractive. The damage to the economy and the quality of life in the province will continue to mount as infrastructure deteriorates. To its credit the Ontario Government has proposed a way out of such a scenario. Needless to say every area of Canada will be paying close attention to how well this can be made to work in Ontario.

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