Intelligence MEMOS

From: David Dodge

To: The Minister of Finance

Date: May 24, 2016

Re: **Infrastructure Spending- Plan Now Needed**

In Budget 2016, you expressed your intent to invest more than $120 billion in infrastructure over 10 years. Phase 1, totaling $11.9 billion, spreads spending over a wide range of objectives primarily in the next two years. Phase 2 promises to deliver more than $100 billion over the remaining eight years, aiming to achieve "a more modern, cleaner economy; a more inclusive society; an economy better positioned to capitalize on the potential of global trade." (p.87).

By necessity, in Phase 1 you will mostly finance municipal and provincial off-the-shelf projects with the aim of boosting aggregate demand in the short term. The Phase 1 goals of improving quality of life in cities, supporting a green economy, and strengthening communities are not primarily aimed at enhancing growth prospects in the longer run, although no doubt some of this spending will contribute to that. For growth, it is imperative that in Phase 2 you put emphasis on the types of infrastructure that most contribute to private sector productivity growth. That would include gateway, transport, communications and energy projects.

Raising aggregate productivity growth is important if Canada is to preserve real income growth in the future. Adverse demographics are leading to lower potential growth over the next decades and a return to high resources prices cannot be counted on to significantly offset the unfavorable effects of aging on real income. Improved productivity growth is the only mechanism to do that for the foreseeable future. A key way by which governments can promote productivity growth is by investing in the type of public infrastructure that most enhances private sector productivity and thereby achieve real income gains for the middle class.

To provide advice on infrastructure investment and manage the federal contribution, Canada needs an independent expert institution, perhaps on the model of Infrastructure Australia. Its goal would be to monitor progress, assess results and update a long-term plan for achieving efficient and effective infrastructure support to productivity growth. In Budget 2016 you pointed in this direction: "New institutions could provide Canada an opportunity to improve infrastructure management across the country…" (p. 88).

Productivity enhancing infrastructure requires increased funding, not only for new construction but also for ongoing debt service, operation, maintenance, and renewal. Construction can appropriately initially be funded through borrowing, but to generate ongoing funding, new infrastructure projects should be designed to generate a current revenue stream from the services they provide, directly through user charges where feasible. These revenues would not only be used to defray the ongoing costs but equally importantly would provide an indication of commercial viability. This would give the government the option of selling the assets to private investors in the future. The proceeds from those sales could be recycled to provide funding for future infrastructure enhancements, thereby limiting the need for continuing government borrowing for that purpose.

In your next budget, you need to provide a real plan for productivity enhancing infrastructure investment, and set out the institutional arrangements to manage that investment.

David Dodge is the former Governor of the Bank of Canada and Chairs the National Council of the C.D. Howe Institute.