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Dealing with Downturn - Is Infrastructure Spending the Answer?

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Sound the alarm! The Canadian economy is weaker than expected, shrinking by 0.5% in September and essentially flat in October, as natural resource prices are crashing right across the board.

Last week, oil prices fell to a 12-year low of $33.16 per barrel for West Texas Intermediate, while Western Canadian Select declined to US$19.92 per barrel. Iron ore prices have plummetted from $190 a ton in 2011 to just $37 today, and copper prices have fallen from $4.50 a pound to below $2.00 last week. Economists keep revising down their expectations for Canadian growth.

With all this weakness, the government is under pressure to speed up its infrastructure spending to stimulate our troubled economy.

We all know the argument: during the great recession of 2009, governments invested huge sums to replace private activity with public. In 2009, the American government spent $105 billion on infrastructure, and Canada spent $13 billion, with a focus on "shovel-ready" projects that could begin right away.

U.S. studies showed some of the projects may not have been all that useful, but the overall stimulus effects prevented a much worse downturn. Canada's stimulus also showed positive but mixed results, providing an economic boost at a critical time.

Mark Twain once said, "The past rhymes but it doesn't echo." Our current economic concerns may seem the same as those of eight years ago, but they are not. Buying short term employment with infrastructure spending is the perfect medicine for dealing with a credit crisis but it's not a strategy to help an economy adjusting to commodity prices which are low and may stay low for a long time.

Many parts of Canada, such as the big cities, would benefit from infrastructure but are less in need of stimulus. Does anyone think that Toronto's construction industry needs a boost? Is there anyone in Montreal, Vancouver or Ottawa who can find a builder in the next six months?

If we're using infrastructure dollars to offset the employment impact of fallen commodity prices, then the program should be concentrated in places like Fort McMurray and Calgary, which may not be optimal. But, if we're going to be investing such important sums, we have to make sure they will benefit Canada's trade capabilities. The program can have a much bigger impact than just temporary job alleviation.

The point is that infrastructure absolutely can improve Canada's economic performance. An IRPP study shows a sustained 10% increase in infrastructure investment could reduce manufacturing production costs by 5% per year—that's like boosting Canada's productivity by 5%! The same study indicated the returns on investment in public infrastructure could be as high as 17% to 25%.

Properly done—meaning planned carefully for economic goals rather than political ones—this proposed infrastructure program could be historic for Canada, significantly changing our competitive situation for the better.

But those gains can only happen if we spend on trade-enabling, economically productive infrastructure—roads, ports, technology, transport corridors and borders. So let's not rush infrastructure dollars out the door, just for the sake of spending, because the stimulus effects, much like the projects, will be disappointing.

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