

Why Investment Matters for Business

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Investment is the economic equivalent of preparing for the future. Individuals set aside time and resources to upgrade knowledge and acquire experience. Businesses spend money on structures, plant and equipment, in an effort to plan for greater product demand and to steal a march on their competitors. Governments put in place infrastructure and programs that can facilitate the future economic decisions of their citizens. All of this forward-looking behaviour can be classified as investment.

Investment comes in two flavours, improvements to human capital and physical capital. The first is the economist's technical term for education and learning. The second is the more familiar activity of building and buying tools that can be used by workers to expand production and meet consumer demands. Both involve access to society's savings, whether these are generated locally through foregone consumption or imported from abroad in the form of financial or direct capital flows.

Investment matters to business because it is a component of overall demand. As such, investment itself is a potentially profitable economic activity. For Canada and Ontario, and outside of recessionary periods, investment has grown faster than the rest of the economy for the past thirty years. As a thought experiment, absent that extra demand, the economy would have grown at only 90 percent of its recorded rate. Having the extra 10 percent was therefore equivalent to \$300 billion in economic transactions that directly benefited businesses.

Another reason for caring about investment is that it lowers costs and enhances efficiency. Since it embodies knowledge and new technologies, investment is a mechanism for managing change. Raising the quality and lowering the cost of products created by the most modern techniques reduces inflation. Expansion of capacity through investment, when accompanied by sufficient resources like skilled labour and construction materials, is also a force for inflation moderation. And productivity is enhanced when workers have more capital to work with and more efficient production techniques. Lower costs and higher productivity will inevitably lead to higher profitability.

Businesses support investment for other reasons. Top quality workers are required to meet ever more sophisticated customer needs. The role of education, especially the formal system owned and operated by the government, is crucial in generating and passing on knowledge and skills. The government, where it has chosen to be active, also has a role in providing adequate infrastructure to create a positive business environment. This includes a modern public transportation and communications system, legal and

policing services, facilities supporting social services, efficient sewage and water treatment, and so on. These external influences on business make human capital development and government investment pressing issues for those engaged in creating wealth.

A final major reason why investment matters to business people is that they are citizens like anyone else. There is a direct link between investment that enhances productivity, and the associated rise in average personal incomes. Thus, investment raises people's standard of living and this, in turn, provides funds to create a better quality of life. Personal and social development are very much conditional on adequate investments to create a more prosperous society in the future.

What creates investment and how does Ontario fare on these attributes?

Investment decisions are mainly done on a decentralized and individual basis. This means that market demand plays a significant role in defining the economic conditions around investing. Adequate economic freedom is required to be willing and able to finance investments, and a sufficiently attractive expected rate of return is needed as a positive incentive to invest. Keynes' famous "animal spirits", that general business mood that is the backdrop to decision-making, is another factor that either spurs or impedes investment.

The good news for Canada is that it ranks seventh in the world on economic freedom, the ability to enter into voluntary economic transactions and protect rightly acquired property. Canada's rating has risen since the mid-1970s, though it has faltered a bit since 2000 owing to a rising regulatory burden and a drop in the perceived impartiality of our legal system.

The bad news for Ontario is that it ranks 51st in North America, behind every US state but West Virginia and the province of Alberta. While Ontario's rating is rising, it still ranks below the North American median - and present government policies are acting to discourage economic transactions and drive its ranking even lower.

Examples of provincial government policies that diminish economic freedom and stifle investment range from court challenges to the 407 toll highway ownership and operation, to greenbelt restrictions, to prohibitions on private capital in constructing health facilities, to restrictions on competition in electricity generation and distribution. The federal government is also inhibiting economic freedom and investment through prohibitions on business ownership in a number of industries, an indiscriminate rise in overall program spending, and a reluctance to reduce the historically high corporate and personal tax burden.

What of "animal spirits" and business' desire to make investments in Ontario? On this count too, there is reason to be concerned. The latest Investment Managers Survey for 2004 shows a drop in the province's typical first or second place ranking to third behind Alberta and British Columbia. Over forty percent of respondents, who manage \$335

billion in assets, believe that the Ontario government is not following appropriate economic policies. Four of the top six concerns are tax related and the second most important issue is infrastructure. Interestingly, aid to the private sector, in other words business subsidies, ranked tenth with a low score of 3.4 out of 10. Yet the provincial government has raised taxes, increased subsidies to the auto sector, and is planning on reducing the capital budget.

Business has an interest in investment because it is the lifeblood of future economic activity. A faster pace of investment leads to greater business activity and the generation of wealth that raises incomes and opportunities in this province. Public policy needs to reflect this reality across the entire portfolio of government programs and business needs to continue to operate in an environment marked by economic freedom and open markets. Following these guideposts can only lead to an improvement in the investment performance of Ontario.