



**THE CENTRE FOR SPATIAL ECONOMICS**

# **The Economic Impacts of Reducing Natural Gas Use in Ontario**

**Prepared for  
Ontario Clean Air Alliance  
and  
Ontario Clean Air Alliance Research Inc.**

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## INTRODUCTION

The Ontario Clean Air Alliance and the Ontario Clean Air Alliance Research Inc. requested the Centre for Spatial Economics (C<sub>4</sub>SE) to undertake a study that looks at the economic impacts of reducing the use of natural gas in Ontario. The possibility of achieving a significant reduction in the use of natural gas has been shown in a study undertaken for Enbridge Gas Distribution that estimated possible reductions in natural gas use on the part of its customers. The current study examines the economic impacts of reducing natural gas in the province by creating a projection for the future economic performance of the Ontario economy that contains a reduction in the use of natural gas that is similar in nature to that shown in the Enbridge Gas Distribution analysis and compares the results of this scenario against a projection that does not contain this reduction.

The next section provides a description of the approach adopted to estimate the impacts of reducing the use of natural gas and the assumptions behind the approach. The third section discusses the expected impacts of reducing the use of natural gas on the economy from a qualitative point of view. The fourth section then presents the quantitative estimates of the impacts found using the assumptions for the reduction in natural gas considered.

## STUDY APPROACH AND ASSUMPTIONS

Enbridge Gas Distribution commissioned a study regarding the possibility of reducing the use of natural gas by its customers in Ontario using a Demand Side Management (DSM) approach (Marbek Resource Consultants Ltd. “Natural Gas Energy Efficiency Potential: Update 2008, Residential, Commercial and Industrial Sectors Synthesis Report,” September 2009). The results of the study suggest estimates of possible reductions in natural gas use for industrial, commercial, and residential customers under different assumptions regarding DSM costs. Under its Economic Potential Forecast, for example, reductions in residential, commercial, and industrial, natural gas usage over a 10-year period are estimated at 18, 29, and 34 percent, respectively. These reductions are to be realized (Marbek, *op. cit.* page 4):

“.. if all equipment and building envelopes were upgraded to the level that is cost-effective from Enbridge’s perspective. All the energy efficiency technologies and measures that have a positive measure TRC.. (net benefits that result from an investment in an efficiency technology or measure).. are incorporated into the Economic Potential Forecast. These technologies and measures are applied at either natural stock turnover rates or at designated years for immediate application.”

The Ontario Clean Air Alliance is interested in estimating the impact on the Ontario economy if a reduction in natural gas use could be achieved in the province as a whole. The assumptions adopted for the reduction in natural gas use found in the Enbridge study serve as a starting point for those used in this study. The reduction is assumed to take place over the 10-year time period 2012 to 2021.

The approach adopted to estimate the economic impacts on Ontario of reducing the use of natural gas employs the C<sub>4</sub>SE macroeconomic model of the Ontario economy. This model is used to prepare two economic projections for the future performance of the economy. The first projection shows the performance of the economy without the reduction in the use of natural gas. The second one shows the performance when the usage of natural gas is reduced. The impacts on the economy are then estimated by comparing the results of the two projections for key economic and fiscal variables such as real Gross Domestic Product (GDP), the Consumer Price Index (CPI), employment, population, and government budget balances.

The C<sub>4</sub>SE macroeconomic model is a multi-sector (industry) model that assumes the existence of a gross output (total value of production) KLEM production technology for the different sectors – KLEM stands for the production inputs of capital, labour, energy, and materials. It incorporates variable input-output coefficients that respond to changes in relative prices for production inputs. For example, increases in the price of natural gas will lead to a reduction in natural gas's share of total inputs to gross output and an increase in the share for the other inputs. The model also incorporates a Green House Gas emissions component that estimates CO<sub>2</sub> equivalent emissions by industry.

The projection that does not contain the reductions in natural gas is called the base case projection. It is created by making assumptions about the key drivers for the Ontario economy such as economic growth and inflation in Ontario's major trading partners, oil prices, natural gas prices, fiscal policy, and so on. The projection with the reductions in natural gas is created using the base case assumptions and then reducing the input shares of natural gas for the various industries along with the consumer expenditure share of natural gas for households. The input shares are variables in the macroeconomic model.

The Enbridge study does not cover all of Ontario's economy. The current study wishes to expand the coverage to the province as whole. The reductions in natural gas use employed are 25 percent for the industrial sector, 20 percent for the commercial sector, and 15 percent for the residential sector. These reductions are lower and, therefore, more conservative than those found in the Enbridge Economic Potential Forecast.

It is assumed that an increase in the share of capital in gross output will occur with the reduction in natural gas use in gross output as firms purchase new energy efficient technologies. As a result, there will be an increase in the share of value-added (net output or GDP) in gross output in the economy. In the case of households, the reduction in the share of natural gas in consumer expenditures is replaced by an increase in the share of the other consumer expenditure categories.

While the Enbridge study provides estimates of reductions in natural gas use, it does not contain estimates of the amount of capital expenditures that would be required to achieve these reductions. The C<sub>4</sub>SE model suggests that the "incremental" increase in the stock of capital over the projection period required to achieve the non-residential natural gas reductions

measured in \$2010 would be about \$4 billion. For the residential sector it is assumed that a \$3 billion increase in the value of residential structures would be required – which is about \$500 per household (occupied housing unit). This assumption is a “rough” estimate, but is similar to the ratio of the increases in non-residential capital stock to natural gas reductions produced by the model. Lower amounts of residential expenditures would reduce the economic impact on the economy and higher ones would increase the impact.

It is also assumed that the prices for capital goods purchased to reduce natural gas usage will not rise from those found in the base case projection other than through possible increases in wholesale and retail trade margins for local firms as demand pressures rise. The prices for imported capital goods remain unchanged from base case values.

While the reductions in natural gas use are assumed to take place over the 10-year period 2012 to 2021, the projection period is extended for another 5 years to 2026. The longer time period is adopted to allow the economy to fully adjust to both the direct and indirect impacts of the reductions in the use of natural gas on the economy.

A final set of assumptions includes the absence of a response of fiscal and monetary policy on the part of governments. The Bank of Canada will not respond to changes in inflation associated with the reduction in natural gas use. Governments will not change policies in the face of changes in their budget balances. Any improvements or deterioration in budget balances will lead to changes in government debt.

## EXPECTED IMPACTS

Before presenting the quantitative estimates of the impact of the reduction in natural gas use it is worthwhile to review the nature of impacts expected from a qualitative point of view – that is, directions of change rather than the estimated size of change.

The reduction in the use of natural gas is to be accomplished by replacing natural gas with more energy efficient capital equipment. This replacement is expected to allow firms to produce the same amount of goods and services they did when using natural gas because the more productive capital replaces the contribution of natural gas use in gross output. It should be noted that the reductions in natural gas use implemented through the model’s input shares will not likely reduce natural gas use in the same proportion. This difference is a result of changes in economic performance caused by the changes in technology. While the share of natural gas in the economy is reduced, the actual size of the economy will increase, which in turn, will lead to additional use of natural gas. Nevertheless, the latter increase will be small in relation to the decline that results from introducing more efficient capital equipment.

Significant increases in investment expenditures in the economy are expected to be observed over the period relative to the base case projection when firms substitute capital for natural gas. Over the long run when the more efficient capital begins to wear out, additional replacement expenditures are expected with the higher valued capital in contrast to the

relatively lower replacement values for the old capital.

The purchase of new equipment and the construction of structures needed to achieve lower gas use will increase production and employment in industries throughout the economy. The increased employment and disposable income will lead to increases in consumer and housing expenditures. These increases, in turn, will lead to additional production and employment, and so on.

Because Ontario does not produce natural gas the reduction in its use will not have a major negative impact on the economy. Nevertheless, firms in the natural gas distribution system are likely to see a reduction in their sales, which will offset somewhat the increases in GDP resulting from the more productive capital.

The fall in natural gas use will be observed through a reduction in provincial imports, which will lead to an improvement in the trade balance (exports minus imports) over the long run. During the period in which the capital is being replaced, nevertheless, the reduction in natural gas imports will be offset by imports of machinery and equipment. The import share of the machinery that will be purchased to reduce natural gas use is high for the province.

The higher GDP associated with the increase in capital to replace natural gas will lead to increases in labour productivity, which, in turn, will result in increases in wages and personal income. The latter will cause an increase in consumer expenditures, in addition to that observed as a result of the increased investment activity mentioned above.

The increased economic activity resulting from the reduction in gas use will also result in an improvement in the budget balances of the federal and provincial governments. This improvement comes from increases in revenues from both income taxes – personal and corporate – and indirect taxes such as the HST. Expenditures also rise as the increase in employment results in additional persons moving into the province, but this increase will be lower than the increase in revenues.

The reduction in the use of natural gas will lead to a reduction in CO<sub>2</sub> emissions. This reduction will be somewhat offset by increases in emissions resulting from a higher level of economic activity associated with replacing the natural gas with more energy efficient capital.

## ESTIMATED IMPACTS

Estimates of the impacts of reducing natural gas use in the province for key economic indicators are shown in Table 1. The impacts for many indicators refer to the percentage differences and level differences from the base case projection values. The level differences for expenditure or income variables are measured in millions of 2010 dollars.

The results for real GDP show a 0.6 percentage point increase from the base case in 2026. This increase represents \$5.1 billion measured in 2010 dollars. It should be noted that part of the

**TABLE 1: IMPACT ON KEY ECONOMIC INDICATORS  
(Level or Percentage Difference from Base Case)**

	2016	2021	2026
Real GDP \$2010 Millions			
% Difference	0.2	0.7	0.6
Difference	1706	5497	5144
GDP Deflator % Difference	0	0.1	0
Consumer Expenditures \$2010 Millions			
% Difference	0.2	0.6	0.5
Difference	787	2694	2630
Residential Investment \$2010 Millions			
% Difference	1.4	3	0.6
Difference	686	1651	394
Non-Residential Investment \$2010 Millions			
% Difference	0.5	1.3	0.7
Difference	346	891	559
Exports \$2010 Millions			
% Difference	0	-0.1	0
Difference	-49	-284	142
Imports \$2010 Millions			
% Difference	0.1	0	-0.1
Difference	204	126	-628
CPI % Difference	0	0.1	0
Hourly Wage Rate \$ % Difference	0.2	0.5	0.2
Employment 000s			
% Difference	0.2	0.4	0.4
Difference	12.2	33.8	28.5
Productivity (GDP/Hour) % Difference	0	0.2	0.2
Personal Income \$2010 Millions			
% Difference	0.3	0.7	0.5
Difference	1215	3738	2612
Corporate Profits Before Tax \$2010 Millions			
% Difference	0.1	0.7	0.6
Difference	73	446	451
Federal Net Lending \$2010 Millions Difference	231	496	148
Provincial Net Lending \$2010 Millions Difference	159	479	443
Natural Gas Final Demand (BCF)			
Difference	-69	-196	-192
% Difference	-6.9	-16.1	-15.4
Total Provincial CO2 Equivalent Emissions (KT)			
Difference	-4107	-13742	-13061
% Difference	-2.1	-6.1	-5.5

increase in GDP and some of its components is a result of an increase in population caused by higher employment leading to additional migration to the province.

Consumer expenditures account for the largest amount of the increase in GDP in 2026 where the percentage difference in expenditures is 0.5. The increase in consumer expenditures is the result of an increase in personal income, which rises 0.5 percent.

The increase in personal income results from increases in employment and wages. The wage rate rises 0.2 percent above base case values while there is a 0.4 percent increase in employment. The increase in employment in level terms is 29 thousand in 2026. Part of the increase in wages is due to the higher productivity that results from the increase in capital with the reduction in the use of natural gas. The fact that the Consumer Price Index (CPI) does not change over the period adds to the purchasing power of the wage increase.

As expected non-residential investment expenditures show a noticeable increase reaching 0.7 percent above base case values in 2026. The latter increase is less than the 1.3 percent observed for 2021 when the use of natural gas is being reduced through investments in energy saving capital.

There is also a 3.0 increase in residential investment to 2021, which falls to 0.6 percent in 2026 as the additional residential capital needed to reduce natural gas consumption is put in place. Some of the higher residential investment is accounted for by an increase in population associated with the higher employment attracting more people to the province.

Imports rise to 2021 in the projection where natural gas use is reduced, which is a result of both higher investment and consumer expenditures. Nevertheless, they fall later as the higher level of investment and associated activity is reduced. The increase in productivity that is caused by the reduction in the use of natural gas reduces business costs enough to cause exports to rise slightly by 2026. This latter increase leads to an improvement in the trade balance of almost \$800 million that year. The reduced costs are also responsible for the increase in corporate profits before taxes over the projection period.

The federal and provincial governments see an improvement in their budget balances with the increased economic activity. The federal budget balance by 2026 is nearly \$150 million higher while that for the provincial government is about \$445 million higher. The sum of these differences over the period suggests about a \$3.8 and \$4.4 billion decline in federal and provincial government debt, respectively.

The percentage reduction in natural gas use for total final demand – which excludes natural gas used to produce electricity – is 15.4 percent in 2026. The reduction in physical units is 192 billion cubic feet of natural gas (BCF). This reduction divided into the increase in GDP in 2026 shows a \$26 million dollar increase in GDP for each 1 BCF of natural gas reduction.

The reduction in the use of natural gas has a noticeable impact on total provincial CO<sub>2</sub> emissions over the projection period. By 2026 the level of CO<sub>2</sub> equivalent emissions is reduced 5.5 percent or 13.1 megatonnes with the replacement of natural gas by the more energy efficient capital.

The estimated percentage impacts on the industries in the economy that are covered in the C<sub>4</sub>SE model are shown in **Table 2**. The impacts on the various industries reflect their relative intensities of natural gas use as well as their involvement in producing and installing capital goods. The construction industry, for example, will see a larger increase in activity as it builds and installs new capital. Industries with high shares of their production represented by natural gas such as primary metals will tend to have larger responses to the reduction in gas use.

The mining and manufacturing industries see relatively large increases in GDP because they use relatively large amounts of natural gas. Within the manufacturing industry the two automobile related industries show the smallest increase while primary metals and other manufacturing, which includes the pulp and paper industry, show relatively large increases in GDP.

As expected the construction industry registers a large increase to 2021 with a 2.0 percent difference between the base case projection and the reduced natural gas projection. This impact declines to 0.7 percent once the conversion to more efficient capital is completed.

The impacts on the service industries reflect in part the higher population associated with the employment increase as well as a reduction in natural gas use. The retail and wholesale trade, finance, insurance, and real estate, and accommodation and food services show the largest increases among private services.

**TABLE 2: IMPACT ON INDUSTRY GDP (%)**  
**(Percentage Difference from Base Case)**

	2016	2021	2026
Total	0.2	0.7	0.6
Agriculture	0.1	0.2	0.2
Forestry	0.2	0.4	0.4
Mining	0.4	1.3	1.3
Manufacturing	0.4	1.3	1.1
Plastics	0.2	0.6	0.5
Motor Vehicle Assembly	0.1	0.4	0.3
Motor Vehicle Parts	0.1	0.4	0.4
Machinery	0.3	0.7	0.7
Fabricated Metals	0.3	0.8	0.6
Primary Metals	0.7	2.1	1.9
Other Manufacturing	0.6	1.8	1.6
Construction	0.8	2	0.7
Utilities	0.1	0.5	0.4
Transportation & Warehousing	0.1	0.3	0.3
Trade	0.2	0.6	0.5
Finance, Insurance & Real Estate	0.2	0.7	0.6
Professional, Scientific & Management Services	0.1	0.3	0.2
Accommodation & Food	0.2	0.6	0.5
Health Services	0.1	0.4	0.4
Other Services	0.2	0.6	0.5
Education Services	0.2	0.7	0.6
Government Services	0.1	0.4	0.5

## APPENDIX: THE CENTRE FOR SPATIAL ECONOMICS

The Centre for Spatial Economics (C<sub>4</sub>SE) monitors and forecasts economic and demographic change throughout Canada at virtually all levels of geography. The C<sub>4</sub>SE also prepares customized studies on the economic, industrial and community impacts of various fiscal and other policy changes, and develops customized impact and projection models for in-house client use. Our clients include government departments, crown corporations, manufacturers, retailers and real estate developers.

The C<sub>4</sub>SE was formed in July 2000 through an initiative of two consulting firms: Strategic Projections Inc. and Stokes Economic Consulting Incorporated. These two firms specialize in demographic and economic research. A key part of this research has been the geographical distribution of demographic and economic activity. The C<sub>4</sub>SE was established as a partnership of SPI and SEC to improve the quality of information and research conducted in Canada and to make the information and research available to organizations requiring such information, and to the public as the opportunity arises. The C<sub>4</sub>SE draws from a list of academics and research consultants on an as needed basis to minimize overhead costs and to obtain the best researchers for the topic at hand.

The staff of the C<sub>4</sub>SE is currently as follows:

Ernie Stokes - Managing Partner

Tom McCormack - Partner

Robert Fairholm - Partner

Robin Somerville - Partner

Aaron Stokes - Staff Economist

Tara Schill - Staff Economist

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Ernie Stokes, the author of this report, is the Managing Partner of the C<sub>4</sub>SE, as well as the President of Stokes Economic Consulting. He has more than 30 years experience as an economic advisor in both the private and public sectors. Ernie has worked both in North America and developing countries. He has a Ph. D. in economics from Queen's University (1979). Prior to establishing Stokes Economic Consulting in 1995 he served as Managing Director, the WEFA Group, Canada (1989 to 1994), as senior economist with the Alberta Energy Company (1987 to 1989), as a senior official with the Canada Department of Finance (1985 to 1987) and as Director of the National Forecasting Group with the Conference Board (1978 to 1984).

Stokes is currently a member of the B.C. Minister of Finance Forecast Council and the Ontario Minister of Finance Forecast Council as well as an expert on the Ontario Minister of Infrastructure Strategy Panel.

For more information on the C<sub>4</sub>SE see our website: [www.c4se.com](http://www.c4se.com)