ONTARIO

NO LONGER A PLACE TO PROSPER

Philip Cross

October 2015

FRASER INSTITUTE

Contents

Executive summary

Ontario, once Canada's economic powerhouse, has experienced an historic reversal of its fortunes within Confederation over the past decade. For decades after the Second World War, Ontario's household income never failed to surpass the national average by 10% to 20%, and its unemployment rate was always below the national average. This superior economic record was achieved despite periodic recessions due to the cyclical nature of its manufacturing industries such as automobile factories. Ontario's enviable economic performance made it a beacon for people from the rest of Canada and around the world. Given its above-average income and large population, Ontario was the lynchpin of the federal equalization scheme redistributing income from so-called "have" to "have not" provinces.

Since 2003, however, economic growth in Ontario has lagged the national average every year. Chronic slow growth sent Ontario's unemployment rate above the national average for the first time on record in 2007. A sputtering economy and rising unemployment culminated in Ontario's real per-capita incomes falling below the Canada average for the first time ever in 2012. Weak revenue growth and rapid government spending resulted in a doubling of Ontario's provincial debt, triggering two ratings downgrades of that debt.

The disturbing trend of these statistics can be seen in the everyday lives of Ontarians. Ontario was once a beacon for migrants from across the Canada and around the world. Ontario in 2002 attracted over half of immigrants arriving in Canada; by 2014 it was no longer their preferred destination, with its share falling to a record low. Since 2004, there has been a net migration of its population to other provinces, as people "vote with their feet" and leave for better opportunities elsewhere. Youths have borne much of the burden of a faltering economy, with their 16% unemployment rate over 10 points above the adult rate, the largest such gap in the country.

The deteriorating competitiveness of Ontario's economy is reflected in how business investment in manufacturing and finance, its traditional bastions of industry, has been surpassed by utilities and transportation, both driven by government investment in infrastructure. The reluctance of the private sector to invest reflects a range of government policies that hurt business. Ontario has the highest labour costs in Canada, reflected in everything from a 50% hike in the minimum wage to creating new statutory holidays. The cost of electricity is also the highest in Canada, reflecting a decades-long view of energy policy as a tool of industrial planning and environmental change rather than a service providing reliable power to industry and consumers at the lowest possible cost. Meanwhile, the continued rapid growth of government debt and the introduction of a new Ontario pension plan promise further tax hikes on firms and households in the near future.

This study begins by reviewing the broad trends in real GDP and household incomes and then examines why its labour-market performance has been so abysmal in recent years, especially for youths, leading directly to a discussion of why interprovincial migrants are leaving and overseas immigrants are avoiding Ontario. The final section reviews the role of the Ontario government's policies in the slowdown, notably the attempt to buttress growth through higher government spending and deficits, the failure of more government capital spending to kick-start more business investment, and the use of energy policy to guide industrial development, which succeeded only in raising costs for both households and businesses in Ontario.

It is a matter of deep concern for all Canadians that its leading province has become a laggard. The Ontario government naively looks to a lower exchange rate for salvation but, after two years of a lower dollar, there are few signs that devaluation alone will improve Ontario's economy. This is not surprising since the real problem in Ontario is the wide array of government policies that mistakenly signal that the public sector, not the private sector, is the engine of economic growth.

Introduction

Ontario was Canada's engine of economic growth for most of its history. For decades after the Second World War, Ontario's household income never failed to surpass the national average by 10% to 20%, and its unemployment rate was always below the national average. This superior economic record was achieved despite periodic recessions due to the cyclical nature of its manufacturing industries such as automobile factories. Ontario's enviable economic performance made it a beacon for people from the rest of Canada and around the world. Given its above-average income and large population, Ontario was the lynchpin of the federal equalization scheme redistributing income from so-called "have"to "have not" provinces.

However, over the past decade there has been an historic reversal in Ontario's fortunes. Its economic growth has consistently fallen short of both its own long-term average and the average elsewhere in Canada. Subpar growth in GDP has been reflected in below-average personal income growth for households, above-average unemployment rates, and an outflow of population to the other provinces, all unprecedented in Ontario's history. Meanwhile, slow economic growth and rapid increases in government spending over the last decade have doubled Ontario's government debt. By 2009, Ontario had qualified to receive equalization payments, confirming its shift from "have" to "have not" status within Confederation.

This study reviews several facets of Ontario's poor economic performance over the past decade. It begins by reviewing the broad trends in real GDP and household incomes. The middle section examines why its labour-market performance has been so abysmal in recent years, especially for youths, leading directly to a discussion of why interprovincial migrants are leaving and overseas immigrants are avoiding Ontario. The final section reviews the role of the Ontario government's policies in the slowdown, notably the attempt to buttress growth through higher government spending and deficits, the failure of more government capital spending to kick-start more business investment, and the use of energy policy to guide industrial development, which succeeded only in raising costs for both households and businesses in Ontario.

1 Economic Growth

For most of the 1990s, Ontario's real growth in GDP surpassed the average in the rest of Canada. From 1989 to 2002, growth in Ontario totalled 42.1% compared with 37.7% in the rest of Canada.[1] This includes the impact of the recession of the early 1990s, which cut GDP in Ontario by 3.9% between 1989 and 1992 compared with slow but positive growth elsewhere. However, over the ten years from 1992 to 2002, Ontario's economy grew 47.9%, significantly faster than the 36.9% gain in the rest of Canada (**figure 1**).

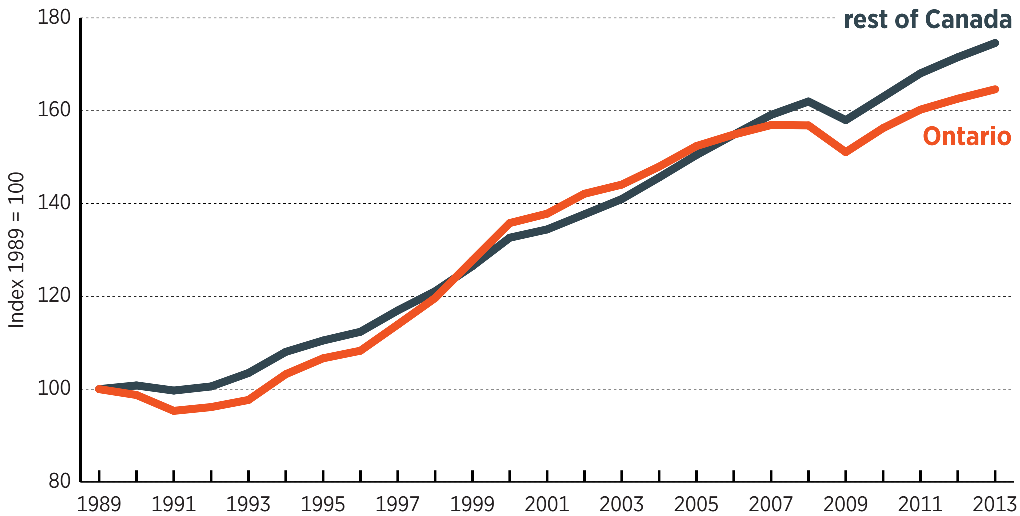
Starting in 2003, Ontario's real GDP growth dropped below the average in the rest of Canada and it has consistently lagged over the ensuing decade. As a result, growth in Ontario between 2002 and 2013 was 15.8% compared to 26.8% elsewhere in Canada. All of the reversal of the gap between growth in Ontario and the rest of Canada originated in slower growth in Ontario, from an annual average of 3.2% between 1989 and 2002 to 1.4% after 2002 (growth elsewhere decelerated from 2.9% to 2.4%). Nor is the shortfall mostly due to the recession; this gap in growth of 11 percentage points was almost equally spread between the years before and after 2008 (5.1 percentage points compared to 4.8 percentage points). Every percentage point of growth lost by Ontario represented $7 billion of GDP in 2013.

As a result of Ontario's relatively slow growth, its share of Canada's GDP has fallen from a high of 41.5% in 2002 to 36.7 % in 2013. Ontario's previous lows were short-term cyclical events associated with recessions in its manufacturing sector in the early 1980s and early 1990s. What is different since 2002 is the persistence of Ontario's relative decline in 10 of the last 11 years (**figure 2**). Ontario's share of jobs has fallen less rapidly over the same period, from 39.5% to 38.6%.

Ontario's dwindling share of the economy in Canada cannot be dismissed as just the inevitable by-product of the resource boom in some other provinces. For one, Ontario also has a large resource base. It is home to Canada's largest utilities and mining industries (excluding oil and gas) and its third-largest forestry industry. Ontario is unmatched in downstream manufacturing that process resources, notably primary metals, lumber, pulp and paper, petroleum refining, food, chemicals and non-metallic minerals.[2] Resource-based manufacturing accounted for 39.9% of all manufacturing in Ontario in 2011. In many cases, such as oil, metals and

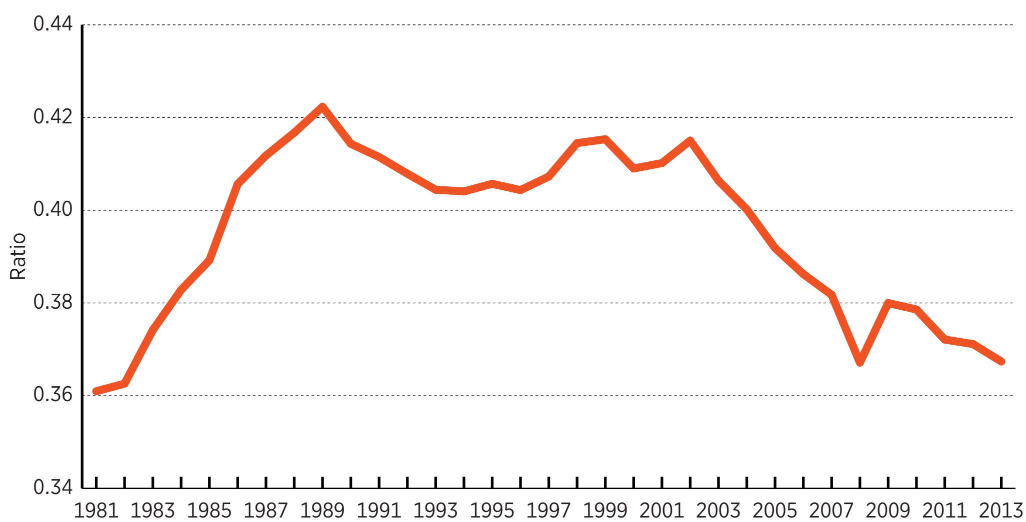
1. The analysis in this section has to use constant, not chained, dollars in order to preserve the additivity of the calculation for the rest of Canada. Statistics Canada, Cansim Table 384-0038.
2. This classification of resource-based manufacturing is based on Philip Cross (2015), *Unearthing the Full Economic Impact of Canada's Natural Resources* (Macdonald-Laurier Institute, May).

Figure 1: Real GDP (index 1989 = 100), Ontario and rest of Canada, 1989–2013



Sources: Statistics Canada, CANSIM Table 384-0038: *Gross domestic product, expenditure-based, provincial and territorial; Canada; 2007 constant prices; Gross domestic product at market prices (x 1,000,000);* Statistics Canada, CANSIM Table 384-0038: *Gross domestic product, expenditure-based, provincial and territorial; Ontario; 2007 constant prices; Gross domestic product at market prices (x 1,000,000).*

Figure 2: Ratio of Ontario's GDP to that of rest of Canada, 1981–2013



Source: Statistics Canada, CANSIM Table 384-0038: *Gross domestic product, expenditure-based, provincial and territorial; annual (x 1,000,000).*

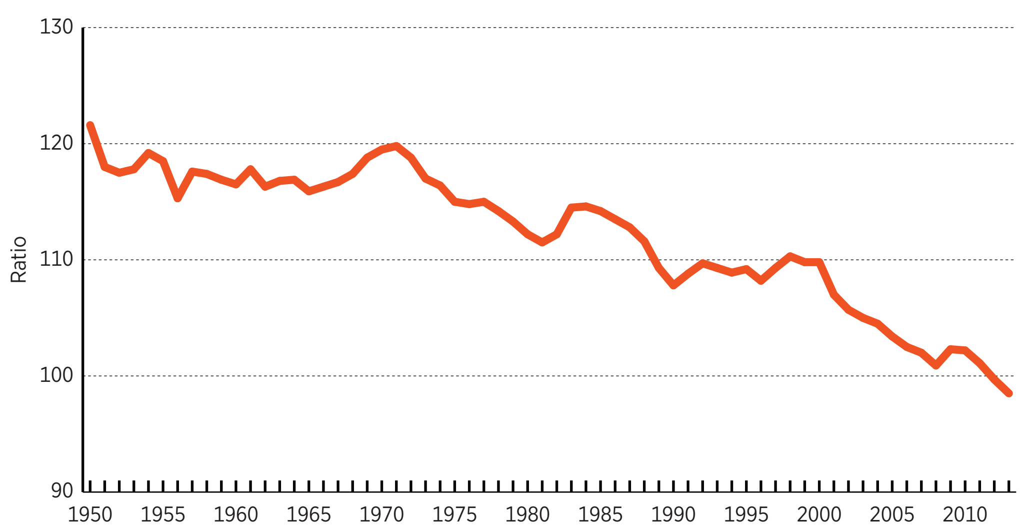
food, the raw material is also imported from other provinces to be processed in Ontario. However, Ontario failed to develop its own resource base during the boom, notably the so-called "Ring of Fire" mining projects in the James Bay Lowlands of northern Ontario. Output from Ontario's resource-based manufacturers fell 8.3%

between 2007 and 2011, compared with a drop of only 2.6% next door in Quebec, with declines in every industry in Ontario except food and petroleum refining. As well, Ontario was slow to shift its focus from traditional export markets in the United States to faster growing markets in Western Canada and overseas. Some of this is the result of poor policies that increased the cost of labour and energy and crowded out business investment (these are discussed in more detail in Section 3).

Incomes

With economy-wide incomes earned in GDP trailing the national average over the past decade, it follows that households' disposable incomes quickly fell below the national average. This is a remarkable reversal of Ontario's relative income performance within Confederation. Real disposable per-capita incomes in Ontario were consistently 20% above the Canadian average in the first two decades after World War II (**figure 3**). Between the mid-1970s and the early 1990s recession, incomes in Ontario fell to 10% above the Canadian average as a result of three severe recessions starting in 1974, 1981, and 1990. This long-term decline was partly reversed during the years Mike Harris was Premier in the 1990s, and by 2000 incomes in Ontario were still 10% above the national average. However, Ontario's relative incomes then fell steadily every year after 2000, until by the 2008 recession they were essentially equal to the Canadian average. After a brief recovery in 2009, the only year of above-average income growth in Ontario in the last 13 years, Ontario sank below the Canadian average for the first time on record in 2012 and 2013.

Figure 3: Ratio of Ontario's real household disposable income to that of rest of Canada, 1950–2013

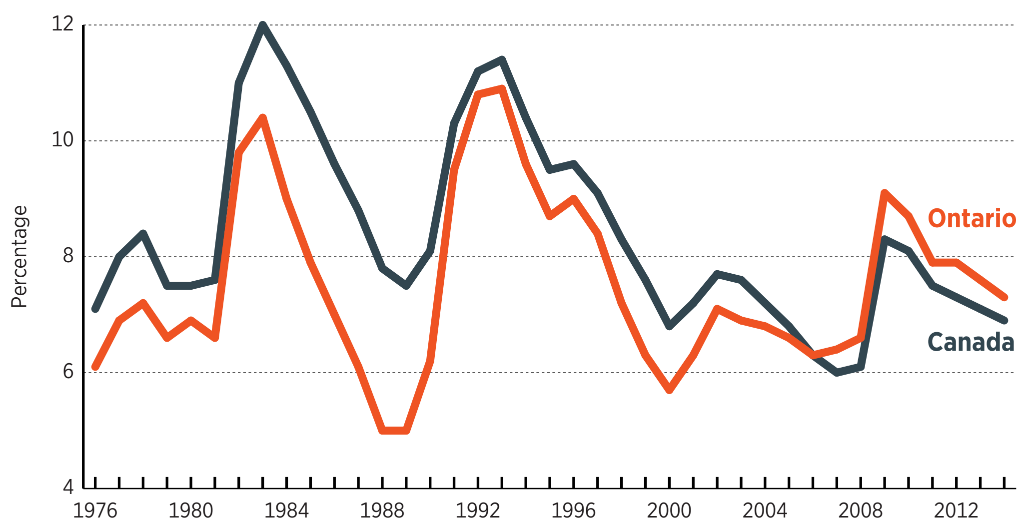


Source: Statistics Canada, CANSIM Table 384-5000: *Real household disposable income per capita (dollars (2002)); annual.*

2 Ontario's Labour Market and Demographic Trends

Ontario traditionally had one of the lowest and most stable unemployment rates in Canada. Ontario's unemployment rate was below the national average every year from 1976 (when data begin) to 2005. The standard deviation (a measure of variability) of its unemployment rate was the second lowest in Canada, behind Saskatchewan.[3] Ontario's unemployment rate first matched the national average in 2006 (at 6.3%), and has been above the national average every year since (**figure 4**). The gap between Ontario's unemployment rate and the national average peaked at 0.7 points during the worst of the 2009 recession, and remained half a point higher in 2014, five years into the recovery.

Figure 4: Unemployment rate, age 15 and over, Ontario and Canada, 1976–2014



Source: Statistics Canada, CANSIM Table 282-0002: *Labour force survey estimates (LFS), by sex and detailed age group, annual.*

Broader measures of Ontario's labour market confirm the growing slack in labour demand. Statistics Canada calculates a measure of both unemployment and underemployment, that includes adjustments for involuntary part-time work,

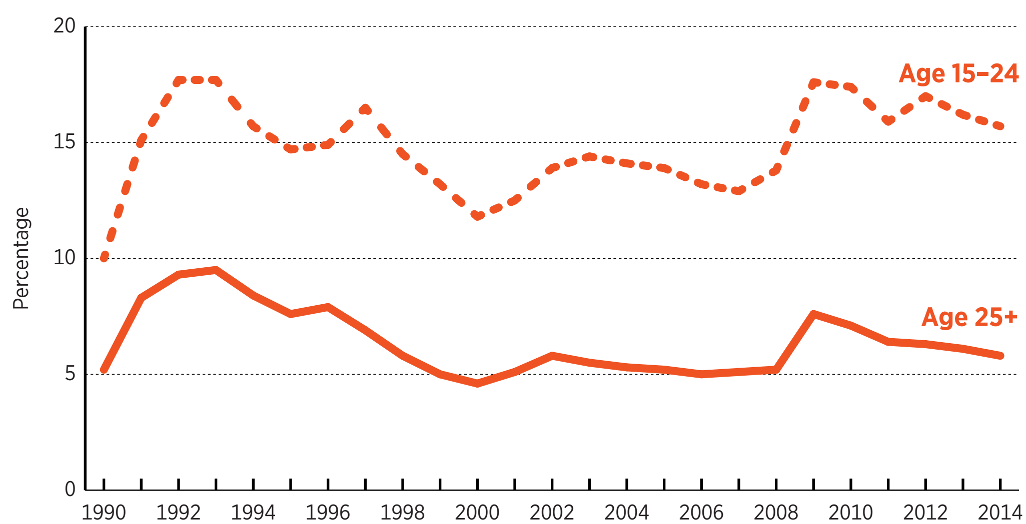
3. The standard deviation of Ontario's unemployment rate between 1976 and 2014 was 1.52, compared with a low of 1.36 in Saskatchewan and a high of 2.47 in British Columbia. Statistics Canada, Cansim Table 282-0087.

discouraged workers, and people waiting to be recalled to work (technically, it is called R8). In 2014, this measure of labour-market slack stood at 10.7% in Ontario, the highest of any province outside of the Atlantic region.[4] Of this 10.7%, two-thirds was accounted for by the conventional measure of unemployment, with the remaining third reflecting various measures of underemployment.

All of the worsening of unemployment in Ontario originated in lower employment. Between its peak in 2004—long before the onset of the 2008 recession—and 2014, Ontario's employment rate fell by 2.8 points, nearly three times as fast as the next worst off province.[5] As a result, Ontario's employment rate went from 1.2 points above national average in 2004 to below the national average in 2014. Employment was particularly weak in its private sector.[6] The only reason unemployment in Ontario did not surge well above the national average was that the participation rate almost kept pace with the falling employment rate, receding 2.6 points. This also was the largest drop in the country.

The burden of Ontario's underperforming economy has fallen disproportionately on its young people. The unemployment rate for people between 15 and 24 years old has been elevated for a decade (**figure 5**). It rose to 14% in the aftermath of

Figure 5: Unemployment rate by age, Ontario, 1990–2014



Source: Statistics Canada, CANSIM Table 282-0002: *Labour force survey estimates (LFS), by sex and detailed age group, annual.*

4. Statistics Canada, Cansim Table 282-0086.
5. All data in this paragraph are from Statistics Canada, Cansim Table 282-0002.
6. Livio Di Matteo, Jason Clemens and Milagros Palacios (2014), *Can Canada Prosper without a Prosperous Ontario?* (Fraser Institute, April): 12.

the 2001 high-tech bust,[7] remaining near that level until 2008, when it jumped to 17% during the recession. This matched its highs in the recessions starting in 1981 and 1990. However, youth unemployment has remained stubbornly high during the recovery, averaging 16% in 2013 and 2014. By comparison, five years after the recession ended in 1982, youth unemployment had been halved to 8%. The difficulty Ontario's youths have finding employment is not reflected in their unemployment rate, as young people have simply withdrawn from the labour force, reducing their participation rate from 67.0% in 2003 to 61.9% in 2014. As a result, youth participation rates in Ontario fell from equalling the national average to the lowest in Canada at 60.1% in 2012 (also the lowest in Ontario history) before a slight recovery.

Persistently high unemployment among youths in Ontario is particularly disturbing because its highly educated labour force always has been one of its strongest advantages. In 2014, Ontario had the second-highest percentage of its population aged 15 years and over who possessed a postsecondary degree or certificate at 54.1% (second only to Nova Scotia at 54.9%).[8]

So why has youth unemployment remained so high in Ontario? It does not reflect a lack of education which, as just noted, ranks near the top in Canada. Nor is it a question of age, since youth unemployment has fallen faster in the rest of the country. Neither can it explained only by a weak labour market in Ontario; the unemployment rate for adults rose to 7.0% during the recession but since then has fallen to 5.8%, the lowest on record outside the period from 2005 to 2008. The employment rate for adults remained at 63.0% during the recovery, slightly below its pre-recession peak of 64%. So a poor outcome for youths is not symptomatic of structural problems in the overall labour market in Ontario, despite the heavy loss of manufacturing jobs over the past decade.

The persistently high level of youth unemployment in Ontario over the past decade must be related to a problem specific to youths in that province. This is because the gap between the employment rate for youths and that for adults is greater in Ontario than in any other province: a 10.5-point spread between the employment rate of 52.2% for youths and 62.7% for adults) (figure 5). One explanation for the particularly poor labour market for Ontario's youths is the steady increase in the minimum wage for Ontario. Youths account for a majority (61.8%) of the jobs that pay the minimum wage in Ontario, with 79% of employed people

7. The crash in the high-tech industry particularly affected Nortel Networks and JDS Uniphase, which had large operations in Ontario.

8. Technically, Quebec has the highest share at 57.5% but this number is inflated by its unique system of *Cegeps*, which helped lift the share holding a postsecondary diploma to 36.4% compared with 28.8% in Ontario). All educational data in this paragraph are from Statistics Canada, Cansim Table 282-0004.

between 15 and 19 years old working for the minimum wage.[9] After being frozen at $6.85 an hour from 1997 to 2003, the Liberal government steadily increased the minimum wage every year between 2003 and 2010 to $10.25 an hour, a hike of 50%.[10] This increase was much faster than for median wages in Ontario, raising the ratio of the minimum wage to median wages from 40.7% in 2003 to 51.3% in 2010.[11] The increase in the minimum wage reflects a confusion that high wages make for prosperity, when in reality "prosperity makes high wages".[12] Mandated high wages not justified by productivity is a recipe for job loss and slower economic growth.

It should be no surprise that youth employment, especially for teenagers, declined as the government raised the minimum wage by 50% (**figure 6**). The government's own Minimum Wage Advisory Panel notes that "studies find that teen employment would drop by 3%–6% if the minimum wage is raised by 10%."[13] Not surprisingly, the 50% hike in the minimum wage over the past decade, when the economy already was weak or in recession, has soured employment prospects for teenagers, with a 13.2% drop in jobs between 2003 and 2014. As a result, the employment rate among workers 15 to 19 years old in Ontario over this period has gone from equalling the national averagwe at 44.4% to the second lowest in the nation at 37.2% (only Newfoundland, where teenagers historically have rarely participated in the labour force, has a lower rate). The loss of jobs for teenagers was evident among both full-time (–18%) and part-time (–12%) positions. Teenage unemployment was little changed at about 20%, as they simply left the labour force. The only province that saw teenage jobs disappear faster over the past decade was Manitoba, where the NDP government raised the minimum wage by 59% after 2003.

Ontario has the highest labour costs in Canada

Despite its weak economy, Ontario has the highest unit labour costs of any province in Canada. According to Statistics Canada, labour compensation per unit of real GDP was $0.67 in Ontario in 2013 (Newfoundland was the lowest at $0.50).[14] Ontario consistently had the highest unit labour costs since data begin in 2007, reflecting both above-average compensation and below-average productivity. The

9. Minimum Wage Advisory Panel (2014), *Report and Recommendations to the Minister of Labour* (Government of Ontario, January): 17.

10. Minimum Wage Advisory Panel (2014), *Report and Recommendations*: 20.

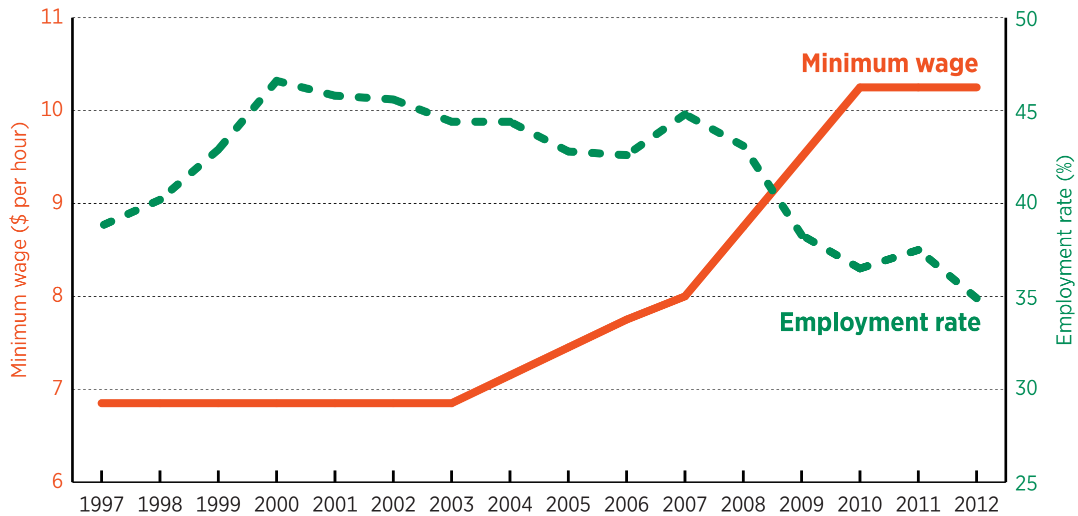
11. Minimum Wage Advisory Panel (2014), *Report and Recommendations*: 30.

12. The quotation is from a Chase Manhattan economist commenting on Herbert Hoover's economic policy, showing that this confusion about the direction of causality between wages and prosperity has existed for decades. Quoted in Amity Shales (2007), *The Forgotten Man* (HarperCollins): 94.

13. Minimum Wage Advisory Panel (2014), *Report and Recommendations*: 34.

14. Statistics Canada Cansim Table 383-0029.

Figure 6: Minimum wage ($/hour) and employment rate (%) for workers 15 to 19 years old, Ontario, 1997–2012



Source: Minimum Wage Advisory Panel (2014), *Report and Recommendations to the Minister of Labour* (Government of Ontario, January); Statistics Canada, CANSIM Table 282-0002: *Labour force survey estimates (LFS), by sex and detailed age group, annual.*

high rate of compensation partly reflects generous pay and benefits for public-sector workers and the legislated 50% increase in the minimum wage. Productivity has been dampened by chronically weak business investment.

The creation of new paid holidays in Ontario further boosted labour costs for employers. The second Monday of February was designated Family Day by the McGuinty government starting in 2008. This forced firms to pay its employees a day's wages for no work, just as a severe recession was beginning. The Wynne government is now considering compelling a half day off for Remembrance Day. Together, these new holidays would increase the cost of each day of labour provided by a full-time employee by 0.6%. As importantly, the new holidays are symbolic of the government's lack of understanding of the importance to restrain costs when the economy is weak and profits already low.

The government is planning on implementing the Ontario Retirement Pension Plan in 2017. This is the equivalent of a $6.5 billion tax hike, which even defenders of an Ontario Pension Plan such as former Bank of Canada Governor David Dodge admit will slow economic growth in the short term as the government withdraws spending power from consumers but without any benefits paid to pensioners for years.[15] It also forces firms to foot the bill for administering another government tax plan.

15. David Dodge and Richard Dion (2014), *Macroeconomic Aspects of Retirement Savings* (C.D. Howe Institute, April).

Ontario's population—no longer "a place to stand, a place to grow"[16]

The reality of Ontario's flagging economy is well understood by ordinary people, as reflected in their choice to leave or avoid Ontario in increasing numbers. For decades, Ontario was the preferred destination within Canada for both migrants from other provinces and for immigrants from abroad. However, these trends have been reversed over the past decade. Ontario has experienced a net loss of population to other provinces since 2004 as people "vote with their feet" and leave the province in increasing numbers. The weak economy also has discouraged immigration from abroad, which has fallen by a third since the turn of the century.

In every one of the 11 years between 2004 and 2014, more people left Ontario for other provinces than moved to Ontario from the rest of Canada (**figure 7**). In total, there was a net migration out of Ontario of 133,167 people in the last 11 years, an average of 12,106 a year.[17] This is the largest and most sustained migration of people from Ontario on record, nearly double the loss in the late 1970s and early 1980s and a third more than in the early 1990s. Nor is this movement just a result of Alberta's boom: in previous booms in Alberta, it drew population from Saskatchewan in the late 1980s (which alone exceeded Ontario as a source of migrants) and British Columbia in the late 1990s (which was the origin of twice as many migrants as Ontario, while Saskatchewan also exceeded Ontario). Over the past decade, Ontario has surpassed all western provinces as a source of migrants.

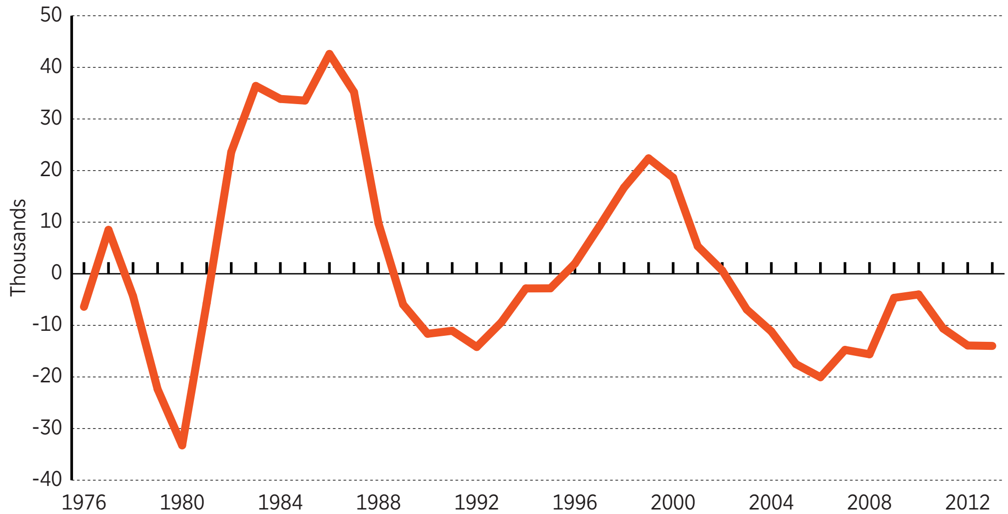
Meanwhile, the inflow of immigrants from abroad to Ontario has slowed. For most of the 1980s and 1990s, Ontario was the new home for more than half of all immigrants to Canada, reaching a peak in absolute terms of 153,000 people in 2002. By 2014, only 101,841 immigrants moved to Ontario; only once in the last 24 years has immigration to Ontario fallen below 100,000. Meanwhile, Alberta, British Columbia and Quebec have increasingly become popular destinations for immigrants. As a result, Ontario's share of immigrants arriving in Canada has fallen from 59.6% in 2002 to a record low of 38.0% in 2014 (**figure 8**).

Some of the migration out of Ontario to other provinces includes an unknown number of immigrants who decided to seek greener pastures than they could find in Ontario. A further rebuke to Ontario is evident in an increase in emigration from Ontario to other countries to 269,749 people in the past decade compared with 227,207 people in the previous decade, although emigration remains below its peak level set in the early 1970s.

16. "A Place to Stand, a Place to Grow" was a song written for the Ontario pavilion at Expo 67 and became its unofficial anthem for the next few decades.

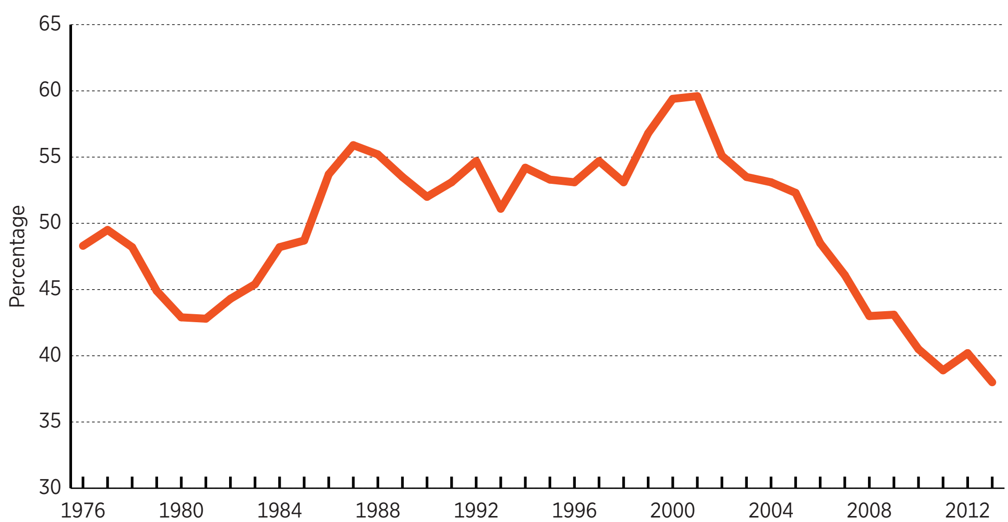
17. All data on population come from Statistics Canada, Cansim Table 051-0004.

Figure 7: Net interprovincial migration (000s), Ontario, 1976–2014



Source: Statistics Canada, CANSIM Table 051-0004: *Components of population growth, Canada, provinces and territories, annual (persons).*

Figure 8: Share (%) of Canadian immigration, Ontario, 1976–2014



Source: Statistics Canada, CANSIM Table 051-0004: *Components of population growth, Canada, provinces and territories, annual (persons).*

The outflow of people to other provinces and the slowdown in immigration has been reflected in slower population growth in Ontario. Population is often ignored as a barometer of the optimism people have about their lives: compare the declining populations of Japan, Germany, and Russia with the growth in the United States.[18] It is well known that household formation and population slowed dramatically in North America during the Great Depression of the 1930s. Within Canada, the population in recent decades has been growing most rapidly in western Canada, notably Alberta, while stagnating or declining in the Maritime provinces and Quebec.

The end result of fewer immigrants arriving in Ontario and more residents moving out has been slower population growth. In the ten years from 2004 to 2014, Ontario's population grew by 10.4%, down from 11.5% in the previous decade; outside Ontario, population growth accelerated significantly from 7.5% to 11.8% over the same two periods.[19] If growth had been sustained at 11.5%, there would have been 136,185 more people in Ontario in 2014, almost exactly equal to the net migration to other provinces of 133,167 people. So the slowdown in population growth is directly attributable to people voting with their feet and moving to other provinces or immigrants bypassing Ontario altogether. Nor can slower population growth be attributed to an aging population in Canada, since all of Ontario's slowdown resulted from migratory flows across its borders.

18. Robert Fogel is the leading champion of using bio-medical data to supplement economic measures of well-being.

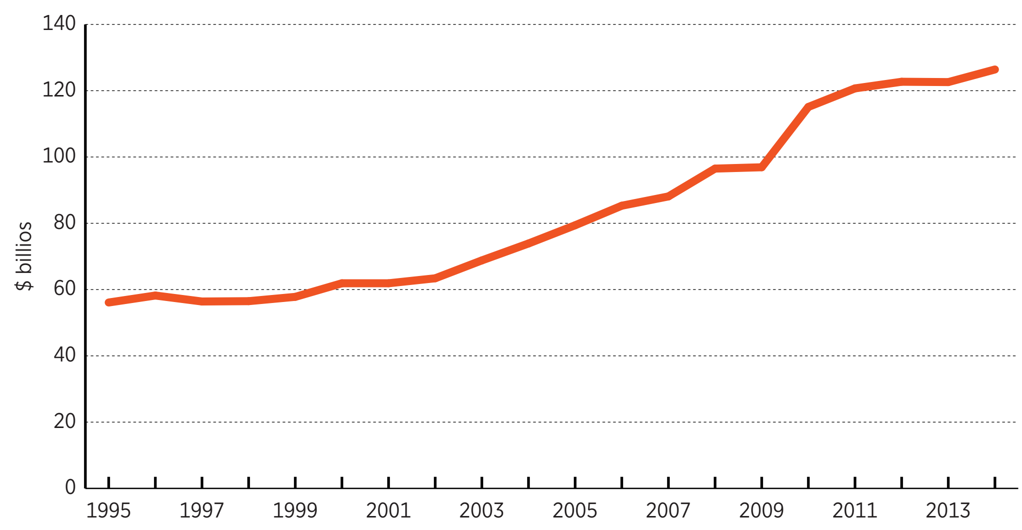
19. All population data in this paragraph come from Statistics Canada, Cansim Table 051-0001.

3 The Ontario Government's Policy Response: Higher Government Spending that Boosts Debt

Faced with a slowing economy, the Ontario government has adopted an agenda of more government spending to kick start the economy. Higher government spending has driven persistent government deficits over the decade, more than doubling Ontario's total debt. Inevitably, the tax burden on Ontarians has begun to creep up, although this is often disguised as higher hydroelectric rates or payroll levies. The results, as documented in the previous two sections, have been abysmal.

From the 1994/95 fiscal year to 2001/02, nominal government spending rose a total of just 13.0% in seven years, or less than 2% a year despite the inevitable increase resulting from the 2001 crash in Ontario's high-tech industry.[20] However, since that time, total spending nearly doubled from $63.4 billion in 2001/02 to $126.4 billion in 2013/14, a jump of 99.4% (**figure 9**) when inflation and population growth only required a 39% increase. Nor can this increase be attributed to the fall-out from the 2008/09 recession: spending growth averaged 8.7% a year from

Figure 9: Ontario government spending ($ billions), 1995–2014



Source: *Public Accounts of Ontario.*

20. All the data for Ontario government spending come from Ontario, Minister of Finance (various years), *Public Accounts of Ontario*.

2001/02 to 2007/08, and 8.4% from 2007/08 to 2010/11. Since then, the government has slowed the growth of spending to 1.6% a year, but has been unable to reduce it in absolute terms. The increase in spending over the past decade was led by annual gains averaging 10.0% for education and 7.2% for health care.[21]

There are two lessons from this pattern of government spending. One is that the government decided to increase spending sharply before the recession, reducing its capacity to boost spending in the event of a sudden downturn in the economy (it is noteworthy that spending growth slowed slightly after the recession, not the typical response of government outlays). Recessions have to be built into any prudent long-term budget plan, since they have occurred regularly every decade dating back to the 1970s. The other lesson is that, as Bob Rae's NDP government discovered when it declared mightily in 1990 that it had decided to "fight the recession and not the deficit", more government spending does little to insulate Ontario from the shock of a recession caused by global forces.

Net government debt in Ontario has risen from $138.8 billion in 2003 to $287.3 billion in 2014. The combination of higher debt and sluggish economic growth lifted the ratio of debt to GDP from 27.5% to 40%.[22] Almost all of Ontario's debt was accumulated during two periods: debt rose $50 billion under Rae's NDP government in the early 1990s, and another $140 billion was incurred during the current McGuinty/Wynne administration. It is noteworthy that all of the debt accumulated since 2002 has occurred without Ontario ever revoking its balanced budget law (The Taxpayer Protection Act).

Ontario's deteriorating financial condition has resulted in two downgrades to its debt rating. These downgrades pushed up the cost of financing debt by as much as 0.25 percentage points in the short term and 0.15 points over the longer term, as documented by the Mowat Centre (which is partly funded by the Ontario government). Mowat Centre analysts, however, called this increase "small and partly fleeting."[23] This "small" hike costs the government $430 million a year, adding to the $11 billion a year Ontario spends on interest payments. Despite record low interest rates, servicing the debt represents 8.4% of all Ontario government spending, dollars that could be used to provide better services to Ontarians or lighten their tax burden. The mindset that dismisses as trivial almost half a billion dollars more spent on servicing debt in return for no tangible service is symptomatic of why

21. Jason Clemens and Niels Veldhuis, eds. (2013), *The State of Ontario's Indebtedness: Warning Signs to Act* (Fraser Institute): 3.

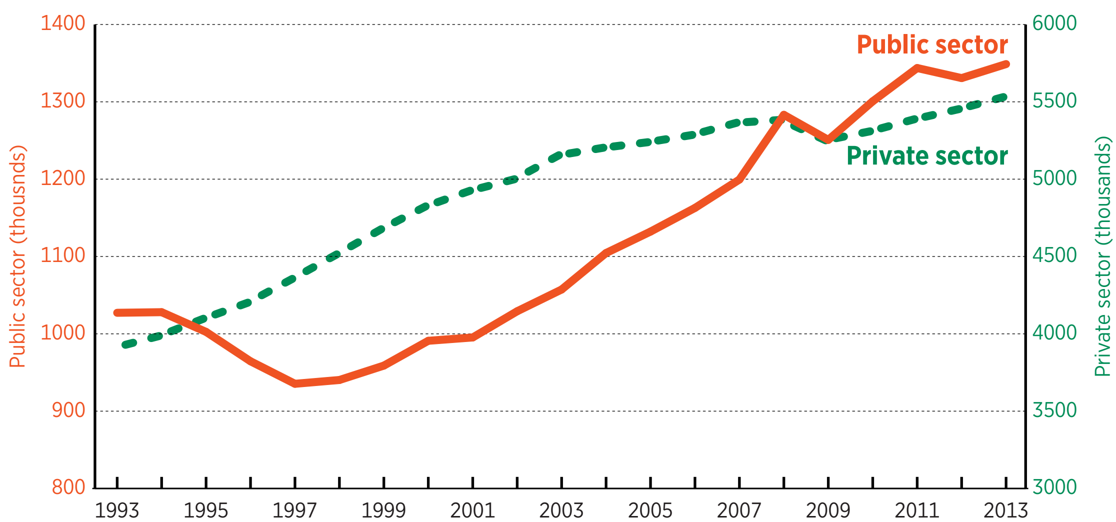
22. For more on the dynamics of debt in Ontario, see Clemens and Veldhuis (2013), *The State of Ontario's Indebtedness*.

23. Kyle Hanniman (2015), *Calm Counsel: Fiscal Federalism and Provincial Credit Risk* (Mowat Research Paper No. 104, February): 19.

Ontario's public spending has ballooned in recent years, with few tangible benefits for taxpayers. When interest rates start to normalize, the cost of servicing the debt will increase rapidly, making it more difficult to return to a balanced budget.

Since 2002, public-sector payrolls in Ontario have expanded by nearly one third, from 1.0 million to 1.35 million (**figure 10**). The tactic of expecting public-sector hiring to lead to more job creation represents a complete failure to learn the lesson from the Common Sense Revolution of the 1990s that cuts to the public service can accompany rapid growth in the private sector. Between 1994 and 1998, public-sector employment in Ontario fell by 88,000 or 9% of all public-sector jobs. However, this drop was more than offset by the creation of over one million jobs in the private sector, which today is still four times as large as the public sector in Ontario. Tending to the health of the private sector, not boosting the public sector, is the only sure way to reinvigorate Ontario's labour market.

Figure 10: Public- and private-sector jobs (000s) in Ontario, 1993–2013

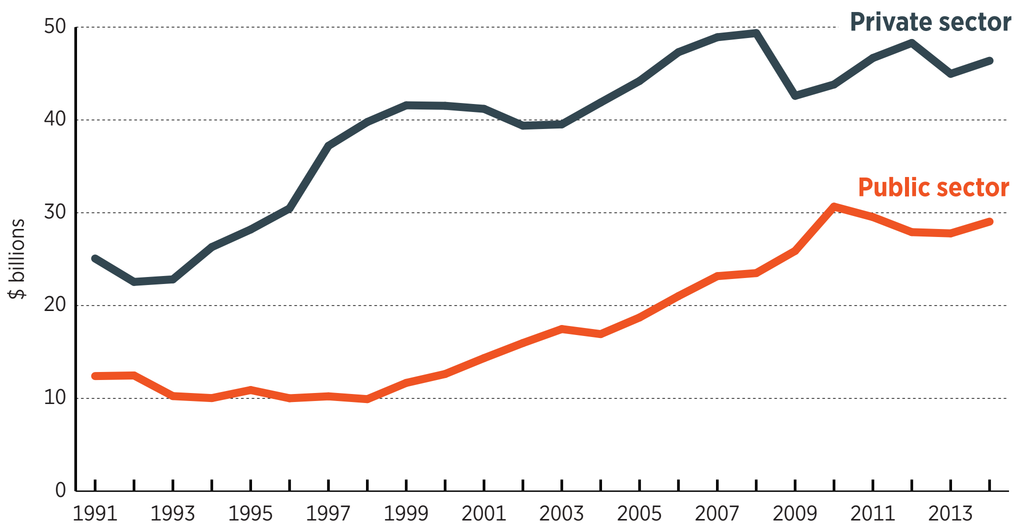


Source: Statistics Canada, CANSIM Table 282-0089: *employment by class of worker and sex, seasonally adjusted and unadjusted; Ontario; Public sector and private sector employees; Both sexes; Seasonally adjusted (x 1,000).*

Business investment

Business investment, which excludes housing, is no longer the driving force of capital formation in Ontario. In its place, investment by the public sector in Ontario has nearly doubled, from $16.0 billion in 2002 to $29.0 billion in 2014 (**figure 11**). This increase was led by utilities, which more than doubled to $8.7 billion, and public administration, which nearly doubled to $13.7 billion. Education and health care both saw increases of over 50% to about $3.4 billion. The total size of public-sector investment undoubtedly is more than $29 billion, but the large government investments in the transportation sector (such as subway extensions in Toronto

Figure 11: Public- and private-sector investment ($ billions), Ontario, 1991–2014



Source: Statistics Canada, CANSIM Table 029-0005: *Capital and repair expenditures, by sector and province; Ontario; Capital expenditures.*

and train systems for commuters in Toronto and Ottawa) cannot be separated from Statistics Canada's data on investment by the transportation industry.

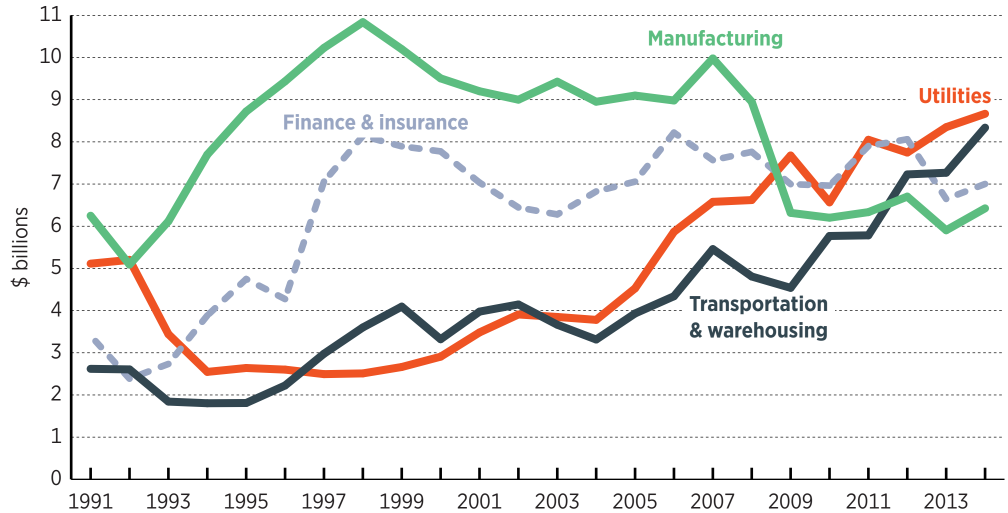
Meanwhile, private-sector investment has risen by a total of only 17.8% since 2002 to reach $46.4 billion in 2014. Business investment peaked in 2008, and has not yet regained this level five years later.[24] As just noted, this overstates private-sector investment since transportation investment by governments cannot be disentangled. The surge in public-sector infrastructure projects helped lift investment by both utilities and transportation above any industry in Ontario in recent years, leapfrogging the traditional bastions of manufacturing and finance where investment has languished (**figure 12**).

The lack of business investment in Ontario threatens its future prosperity. Some high profile decisions to stop investment in Ontario include the decision by Cliffs Natural Resources to write-off hundreds of millions related to its "Ring of Fire" Bloom Lake mining project.[25] The brief surge in investment in mining was the main reason for the spike in investment in resources after the recession, but the momentum has not been sustained. No new automobile-manufacturing plants

24. For more on business investment in the public and private sectors, see Philip Cross (2014), *The Public Purse versus Private Wallets: Comparing Provincial Approaches to Investing in Economic Growth* (C.D. Howe e-Brief, June).

25. Besides $500 million spent on the project, mostly for mineral rights, it will cost another $650 and $700 million to close the Lake Bloom mine, mostly to cover railroad transport contracts. See Adrian Morrow and Eric Atkins (2014, November 21), Cliffs Pullout Forces Ontario Action on Ring of Fire (*Globe and Mail*).

Figure 12: Non-residential business investment ($ billions), Ontario, 1991–2014



Source: Statistics Canada, CANSIM Table 029-0005: *Capital and repair expenditures, by sector and province, annual (dollars x 1,000,000)(1,2): Capital and Repair Expenditures, Actual, Preliminary Actual and Intentions - 2803.*

have been undertaken in Ontario in over a decade, while General Motors will close a second shift at its Oshawa operations. The weakness in capital spending by automobile manufacturers is the main factor behind slumping investment in manufacturing overall. The major business investments in Ontario recently were made by firms the government had to pay to invest, such as the $220 million it gave Cisco.[26]

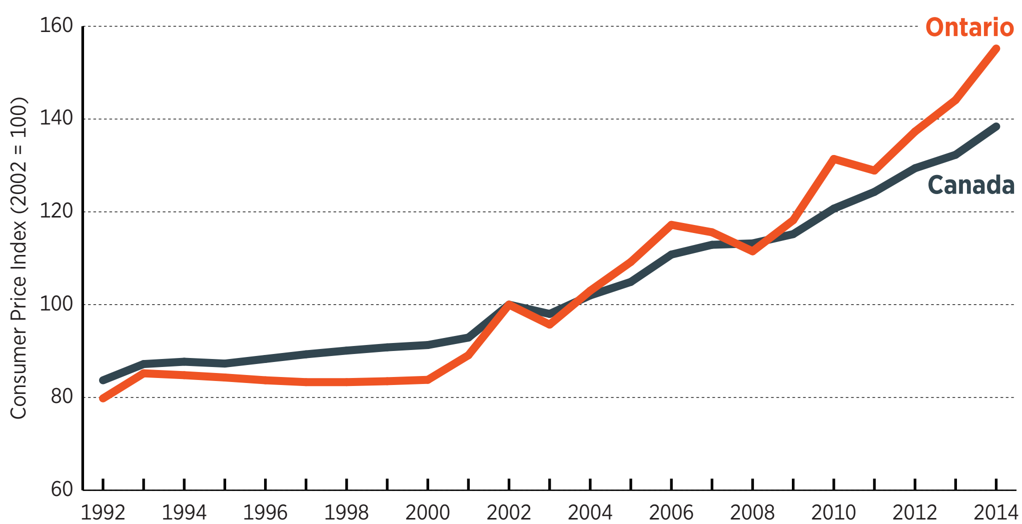
Energy

Nothing better symbolizes what has gone wrong with Ontario than its energy policy and the cost of hydroelectric power. This failure of policy dates back decades, irrespective of the party in power (including NDP, Conservative, and Liberal administrations), which suggests a large part of the problem originates in the bureaucracy at Ontario Hydro (and its successors). The problem can be summarized as the failure of energy policy to focus on what should have been its primary goal: reliably delivering power to Ontarians at the lowest possible price. Instead, bureaucrats and politicians have used hydroelectric as a tool to achieve other goals, including industrial planning, a prop to faltering overall growth, and a catalyst for environmental change. At the same time, this bureaucracy captured a disproportionate share of the benefits. Last year, over half of workers at Ontario Power Corp. earned more than $100,000.[27]

26. See Adrian Morrow (2014, Dec. 26), Do Job-Creation Subsidies Create Jobs? (*Globe and Mail*).
27. Office of the Auditor General of Ontario (2014), *Annual Report* (December): 6.

The result has been a much faster increase in electricity prices for Ontario than in the rest of Canada. After lagging through the 1990s, including a slight drop between 1992 and 2000, electricity prices have taken off from 6.5¢ per kwh to 15¢, with the government warning rates will hit 20¢ by 2019. The increases have occurred in four distinct steps (the brief periods of rate freezes or small cuts in **figure 13** often coincide with elections; it should also be noted that the data are from the Consumer Price Index, which compare the relative rate of increase of energy costs in Ontario and Canada but not their level in absolute terms). The initial increase after 2000 associated with the break-up of Ontario Hydro into three pieces in the final days of the Conservative government and the debt service required for the legacy of its nuclear plants (including the closure of the Pickering plant and the refurbishing of others). The increases starting in 2009 reflected the decision to subsidize renewable energy sources, build new gas plants to replace coal plants and compensate for the intermittent nature of supply from renewables, and a $2 billion charge for the Smart meter program.

Figure 13: Consumer Price Index (CPI), electricity prices, Ontario and Canada, 1992–2014



Sources: Statistics Canada, CANSIM Table 326-0021: *Consumer Price Index, annual (2002 = 100).*

The decision in 2009 to emphasize the development of renewable sources of solar, wind, and biomass was particularly ill considered and costly to users. The idea was conceived to use renewable energy as a tool to fight the recession; the interdependence of the two is reflected in the title of the “Green Energy and Green Economy Act” of 2009, which linked local content provisions to the supply of renewable energy power. The strategy of using renewable energy as a way to create jobs, during the recession or any other time, was always disingenuous: as the

Auditor General noted, "studies in other jurisdictions have shown that for each job created through renewable energy programs, about two to four jobs are often lost in other sectors of the economy because of higher electricity prices".[28] Moreover, the World Trade Organization ruled that the local content provisions violated its rules. By that point, Ontario Hydro had already agreed to many contracts guaranteeing prices to power generators. The Auditor General estimates that users have paid $50 billion to cover the gap between the prices guaranteed to power generators and the market price by 2015. Furthermore, the Auditor General estimated that the $2 billion the province spent on its Smart Meter program was not going to achieve its conservation goals.[29]

High electricity rates are a major competitive disadvantage for industrial users. Analysis by the Association of Major Power Consumers (AMPCO) in Ontario found that "Ontario has the highest industrial rates in North America" and that "the disparity in rates is growing".[30] Industrial rates in Ontario vary between $76 and $94 (per MWh) compared with $45 in Quebec, $54 in New England, and $32 in the Midwestern United States. This is especially important for industries that require large energy inputs, such as chemicals, primary metals, petroleum refining, and pulp and paper. Ontario hydroelectric customers face more price hikes from the government's recent decision to adopt a cap-and-trade system.

Pensions

Like all Canadian employees, Ontarians already pay nearly 10% of their incomes up to $52,000 on the Canada Pension Plan. The proposed Ontario Retirement Pension Plan (ORPP) will force employees and employers to cumulatively pay an additional 3.8%, but on income earned up to $92,000. The effect will be the same as a tax increase of $1,000 for individuals making the maximum contribution.

The government justifies the plan by its claim that young workers today will lack adequate saving for retirement. There are several flaws with these arguments. They are based on model simulations that do not capture all the assets households own or have access to within their family, do not allow for a behavioural response by people faced with the need to work or accumulate more assets, and do not warn of the demonstrated inability of models to forecast social trends and economic outcomes decades in advance.[31]

28. Office of the Auditor General (2011), *Annual Report 2011* (Government of Ontario): 91.

29. Auditor General of Ontario (2014), *Annual Report 2014*: 6.

30. Association of Major Power Consumers (no date), Benchmarking, *Analysis*, <http://www.ampco.org/index.cfm?pagepath=Analysis/Benchmarking&id=36556>.

31. For a detailed review of these shortcomings, see Philip Cross (2014), *The Reality of Retirement Income in Canada* (Fraser Institute, April).

The end result is that lower- and middle-income employees in Ontario will be forced to spend almost 12% of their income on saving for their pension. To put that in perspective, households will be compelled to spend more on pensions than they spend on any other goods or service except their housing. By comparison, Canadians in 2014 spent less than 10% of their income on basic necessities such as food, automobiles, gasoline, health care, and financial services. They spent less than 5% on items such as communications (including all the gadgets for social media), furnishings, and travel abroad.[32]

Forcing young families struggling to raise children and make mortgage payments to spend more money on their pension at the expense of other priorities guarantees a squeeze on their standard of living. Placing this type of downward pressure on take-home incomes is especially unnecessary after the federal government's decision to raise the annual contribution limit for Tax Free Savings Accounts to $10,000, which can be carried forward indefinitely. This would allow young families to concentrate their resources on raising their children and paying off their home, and then putting money into a TFSA for retirement when the kids have left and the mortgage is paid. This follows a life-cycle pattern observed by Fred Vettesse.[33] Instead, the compulsory ORPP forces young people to accept a lower standard of living today, often so they can have a higher standard of living when they retire than they have today.[34] People should be able, and trusted, to allocate their income across their lifetime as they decide best suits their circumstances.

The ORPP adds to the 8% payroll taxes that employers already pay for various programs. These include the Canada Pension Plan, Employment Insurance, the WSIB, and the Ontario Health Premium, each with their own rules and administrative burden. The health levy is the most unnecessarily complex: instead of simply integrating it into the income-tax code, the premium has six different levels depending on income, plus three transition zones.[35] The ORPP will add to the administrative burden on employers, on top of its financial cost.

32. Statistics Canada (2015) Cansim Table 380-0067: Household Final Consumption Expenditure. <http://www.statcan.gc.ca/eng/nea/hr2012/data/cansim/tables/iea/c380-0067>.

33. Fred Vettese (2013), Why Canada Has No Retirement Crisis (*Rotman International Journal of Pension Management* 6, 1 [Spring]).

34. See Malcolm Hamilton (2015), *Do Canadians Save Too Little?* (C.D. Howe Institute Commentary 428, June).

35. For a complete description, see Thomas McDonnell and David McDonnnell (2005), Policy Forum: Taxing for Health Care—The Ontario Model, 2004 (*Canadian Tax Journal* 53, 1): 107–134.

Conclusion

For most of Confederation, Ontario has been the workhorse of the national economy. Above-average incomes and below-average unemployment in Ontario were the foundation for national prosperity and the basis for the equalization programs administered by the federal government.

Therefore, it is a matter of deep concern for all Canadians that its leading province has become a laggard. The Ontario government naively looks to a lower exchange rate for salvation but, after two years of a lower dollar, there are few signs that devaluation alone will improve Ontario's economy. This is not surprising since the real problem in Ontario is the wide array of government policies that mistakenly signal that the public sector, not the private sector, is the engine of economic growth.

Despite a lower dollar that favours its exporters, firms in Ontario face larger competitive disadvantages. Some of these costs seem small in themselves, but cumulatively have a large impact. Businesses have the highest unit labour costs in Canada, a reflection of government policies that raised the minimum wage and forced companies to pay for more statutory holidays. Firms face the highest electricity costs in North America. Ontario's new pension plan will add to the direct and administrative cost of doing business, while rising government debt promises future tax increases. Given all these costs, it is not surprising that firms are unwilling to invest more in Ontario. It is telling that utilities and transportation, much of it by the public sector, have surpassed manufacturing and finance as the leading source of investment in Ontario; this reflects how government has forgotten that infrastructure is not needed unless there are goods to ship and jobs for people to commute to.

Beyond the statistics of an underperforming economy, the most telling comment on Ontario's shift from "have" to "have not" status within Confederation lies in its demographics. For over a decade, people have been "voting with their feet" and leaving the province for elsewhere in Canada in unprecedented numbers, while Ontario's share of overseas immigration has fallen to a record low. Meanwhile, its young people are trapped by the largest gap between adult and youth unemployment in Canada. It is this loss of potential human capital, even more than languishing business investment, that clouds Ontario's future.

About the author

Philip Cross

Philip Cross worked for 36 years at Statistics Canada, the last few as its Chief Economic Analyst. He wrote Statistics Canada's monthly assessment of the economy for years, as well as many feature articles for the *Canadian Economic Observer*. After leaving Statistics Canada, he has worked as a contract researcher for a variety of organizations. He has been widely quoted over the years, and now writes a bi-weekly column for the *National Post* and other papers.

Acknowledgments

The author would like to acknowledge the helpful comments and insights of several anonymous reviewers. As the researcher has worked independently, the views and conclusions expressed in this paper do not necessarily reflect those of the Board of Directors of the Fraser Institute, the staff, or supporters.

About the Fraser Institute

Our mission is to improve the quality of life for Canadians, their families and future generations by studying, measuring and broadly communicating the effects of government policies, entrepreneurship and choice on their well-being.

Notre mission consiste à améliorer la qualité de vie des Canadiens et des générations à venir en étudiant, en mesurant et en diffusant les effets des politiques gouvernementales, de l'entrepreneuriat et des choix sur leur bien-être.

Peer review—validating the accuracy of our research

The Fraser Institute maintains a rigorous peer review process for its research. New research, major research projects, and substantively modified research conducted by the Fraser Institute are reviewed by experts with a recognized expertise in the topic area being addressed. Whenever possible, external review is a blind process. Updates to previously reviewed research or new editions of previously reviewed research are not reviewed unless the update includes substantive or material changes in the methodology.

The review process is overseen by the directors of the Institute's research departments who are responsible for ensuring all research published by the Institute passes through the appropriate peer review. If a dispute about the recommendations of the reviewers should arise during the Institute's peer review process, the Institute has an Editorial Advisory Board, a panel of scholars from Canada, the United States, and Europe to whom it can turn for help in resolving the dispute.

Publishing Information

Distribution

These publications are available from <http://www.fraserinstitute.org> in Portable Document Format (PDF) and can be read with Adobe Acrobat® or Adobe Reader®, versions 7 or later. Adobe Reader® XI, the most recent version, is available free of charge from Adobe Systems Inc. at <http://get.adobe.com/reader/>. Readers having trouble viewing or printing our PDF files using applications from other manufacturers (e.g., Apple's Preview) should use Reader® or Acrobat®.

Ordering publications

To order printed publications from the Fraser Institute, please contact:

- e-mail: sales@fraserinstitute.org
- telephone: 604.688.0221 ext. 580 or, toll free, 1.800.665.3558 ext. 580
- fax: 604.688.8539.

Media

For media enquiries, please contact our Communications Department:

- 604.714.4582
- e-mail: communications@fraserinstitute.org.

Copyright

Date of issue

October 2015

ISBN

978-0-88975-369-3

Citation

Philip Cross (2015). *Ontario—No Longer a Place to Prosper.* Fraser Institute. <http://www.fraserinstitute.org>.

Cover design

Renee Depocas

Supporting the Fraser Institute

To learn how to support the Fraser Institute, please contact

- Development Department, Fraser Institute
  Fourth Floor, 1770 Burrard Street
  Vancouver, British Columbia, V6J 3G7 Canada
- telephone, toll-free: 1.800.665.3558 ext. 586
- e-mail: development@fraserinstitute.org
- website: <http://www.fraserinstitute.org/support-us/overview.aspx>

Purpose, Funding, and Independence

The Fraser Institute provides a useful public service. We report objective information about the economic and social effects of current public policies, and we offer evidence-based research and education about policy options that can improve the quality of life.

The Institute is a non-profit organization. Our activities are funded by charitable donations, unrestricted grants, ticket sales, and sponsorships from events, the licensing of products for public distribution, and the sale of publications.

All research is subject to rigorous review by external experts, and is conducted and published separately from the Institute's Board of Directors and its donors.

The opinions expressed by authors are their own, and do not necessarily reflect those of the Institute, its Board of Directors, its donors and supporters, or its staff. This publication in no way implies that the Fraser Institute, its directors, or staff are in favour of, or oppose the passage of, any bill; or that they support or oppose any particular political party or candidate.

As a healthy part of public discussion among fellow citizens who desire to improve the lives of people through better public policy, the Institute welcomes evidence-focused scrutiny of the research we publish, including verification of data sources, replication of analytical methods, and intelligent debate about the practical effects of policy recommendations.

Editorial Advisory Board