EXECUTIVE SUMMARY

Ontario vs. the US Rust Belt: Coping With a Changing Economic World

by Robert P. Murphy, Jason Clemens, Joel Emes, and Niels Veldhuis

Since the recession, Ontario has recorded large, consistent budget deficits, which have served to enlarge the province's already enormous debt load. According to a prominent narrative at Queen's Park, policymakers are not to blame for this distressing fiscal trend because the province has been struck by economic forces beyond its control. These outside forces include a higher dollar and global restructuring in manufacturing.

This study subjects this narrative to empirical scrutiny by comparing the economic and financial performance of Ontario with other industrial jurisdictions such as Quebec and the US Rust Belt states over the 1999–2013 period. The "Rust Belt" states include Indiana, Michigan, Ohio, Pennsylvania, and Illinois. The selection of this peer group controls for the regional reliance on manufacturing; a number of Rust Belt states had higher concentrations of manufacturing than did Ontario or Quebec.

The main finding is that both Ontario and Quebec had markedly worse financial performances compared to the Rust Belt states even though they enjoyed much stronger economies. For instance, Ontario's real GDP grew at a compound annual rate of 1.9 percent with Quebec close behind at 1.8 percent. In contrast, the fastest growing Rust Belt economy was Indiana's 1.3 percent, while the dismal Michigan economy actually shrank in real terms between 1999 and 2013 (-0.2 percent on average).

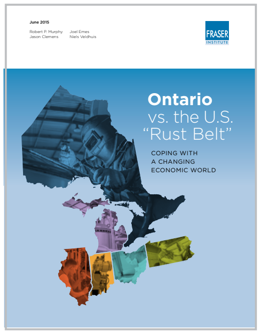
Similarly, Ontario outperformed all of the Rust Belt states on private sector employment growth (1999 to 2013). Ontario recorded an annual average rate of 1.2 percent private sector job growth, which was second only to Quebec's 1.4 percent annual average. Among the Rust Belt states, Pennsylvania recorded the highest annual average private sector job growth over this period of 0.6 percent, half the rate of Ontario. Illinois (-0.1 percent), Ohio (-0.2 percent) and Michigan (-0.7 percent) all recorded, on average, contractions in private sector employment over this period.

Despite Ontario's and Quebec's comparative economic strength, both performed quite poorly on measures of government finances. For instance, both Ontario and Quebec have accumulated far more government debt than the Rust Belt states. Specifically, as of 2011/12, Quebec had a net provincial government debt of 49 percent of GDP, a level that was five percentage points higher than it had been in 1998–99, while Ontario had a net debt of 36 percent, an increase of six percentage points. In total contrast, the Rust Belt states all ended the period with 5 percent or less in net debt as a share of GDP.

Even more disturbing, by 2012/13 the US Rust Belt states had all restored healthy budget surpluses (according to the broad measure used), while Ontario and Quebec continued to run large deficits. Despite enjoying higher population and aggregate economic growth, the provinces are in a much deeper debt hole.

One of the main explanations offered by Queen's Park with respect to the poor economic performance is the appreciation of the Canadian dollar vis-à-vis the USD since the early 2000s. However, in this study we show that the "strong" Canadian dollar of recent years is really just unwinding the weak Canadian dollar of the 1990s. Considering the period 1976 to the present, the CDN/USD exchange rate is currently very near its historical average. In any event, with expected tightening of US Federal Reserve policy in the near future, the "strong" Canadian dollar cannot serve as an excuse for Ontario profligacy going forward.

Simply put, bad policies in Ontario have led to poor financial performance when compared to other industrial jurisdictions, who like Ontario have weathered a global restructuring in manufacturing. The implication is that better policies can improve the finances and overall economic performance of the province. Critically, there seem to be lessons worth at least considering from both Indiana and Michigan in terms of their responses to not only the global recession but also restructuring in manufacturing.



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Net Government Debt as Share of GDP, 1998-99 & 2011-12