EXECUTIVE SUMMARY

Ontario's One Cylinder Economy

Housing in Toronto and Weak Business Investment

by Philip Cross

Economic growth in Ontario has lagged Canada since 2003, reducing the province to 'have-not' status within Confederation. One theme that runs throughout the paper's analysis is the persistent weakness of Ontario's manufacturing sector, where output has fallen in absolute terms since the recession that began nearly a decade ago. Given that manufacturing is still Ontario's third largest industry, it is critical that its health be restored if the Ontario economy is to fully recover and prosper.

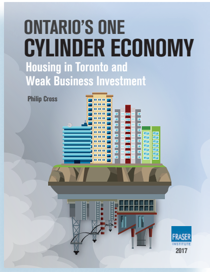
Manufacturing has recovered in other provinces in Canada, notably Quebec despite the well-documented woes of Bombardier. Manufacturing has become a larger share of Quebec's economy than of Ontario's, partly a reflection of how manufacturing has shrunk from 21.7% of Ontario's economy in 2002 to 12.1% in 2015. This suggests manufacturing's problems in Ontario cannot be blamed on global factors such as US export demand or the exchange rate, but are something specific to Ontario. The paper finds that the high cost of doing business in Ontario is the main drag on growth. These costs include everything from high electricity rates, the rising cost of labour and high income taxes to the indirect cost of a heavy regulatory burden. In particular, energy-intensive manufacturing has fared much better in Quebec than in Ontario in recent years, helped by Quebec's much lower electricity prices. As a result of the high costs in Ontario, the temporary weakness that inevitably accompanied the 2008/09 recession has become chronically weak growth. Sluggish growth has erased Ontario's historically lower unemployment rate than in neighbouring Quebec, a province long known for extensive government intervention in the economy and large government debts.

More broadly, business investment in manufacturing and elsewhere has languished during the recovery. Overall, investment plans are for $50.9 billion in 2017, compared with their pre-recession peak of $53.8 billion. Most of this reluctance to invest originates in the manufacturing industry. This reflects a number of factors. While the automobile industry has retooled its existing plants, no new plants have opened since 2009 while existing capacity continues to be shuttered, with another line scheduled to close this summer. Investment has fallen even more in other industries ranging from petroleum refining to lumber, computers and electronics, and rubber and plastics.

Chronically weak growth in manufacturing has left Ontario increasingly dependent on housing, which has contributed

over 29% of its income growth in the past year, even before a spike in housing starts and prices early in 2016. Besides a sharp increase in housing starts in Toronto, there has also been a marked shift from the building of single-family homes to multiple-unit dwellings, mostly apartment and condominium buildings. The squeeze on the supply of single-family homes, partly the result of land use regulations, helped fuel the surge in their prices. At the same time, the increased supply of multiple units is threatened by the extension of rent controls by the provincial government.

With a growing chorus of analysts and the federal government warning that a possible bubble in Toronto's housing market risks deflating, this leaves Ontario precariously dependent on a potentially unstable and unsustainable source of growth. A correction in the Toronto housing market would leave both Ontario's economy and government fiscal projections vulnerable to a downward revision.



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