SPECIAL REPORT

TD Economics

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Executive Summary

STAYING ON TRACK: SUSTAINING TORONTO'S MOMENTUM AFTER THE GLOBAL RECESSION

Moving the Region Forward in a Modest Growth, Fiscally-Constrained Environment Will Require New Approaches

At the request of the Greater Toronto CivicAction Alliance (CivicAction), we have undertaken this long-term economic assessment of the Toronto region in order to help frame the discussion – and identify trends to address – at the upcoming Forum *Our Region, Our Move* to be held in Toronto on April 17, 2013.

It has not been perfectly smooth sailing for Toronto region's economy since the outbreak of the global financial crisis in 2008-09. Still, Canada's largest urban region (which includes the Greater Toronto Area and the City of Hamilton) has exhibited a degree of strength and stability that has made waves internationally. In particular, gains in employment and living standards have far outstripped those of most competing large North American city-regions. Moreover, most parts of the Toronto region economy have contributed to the relative strength, led by the City of Toronto, which enjoyed a steady inflow of young, highly-skilled workers to its downtown core.

Looking ahead, the big task at hand for leaders in the Toronto region is sustaining this forward momentum amid a number of significant longer-term challenges to growth and prosperity. On pages 11-23 of this report, we highlight seven key structural issues, which have received varying levels of regional attention and progress in recent years:

- Worsening gridlock – while improvements in land-use planning have spurred increased intensification in the Toronto region over the past decade, congestion has been getting worse. According to the Toronto Region Board of Trade, car dependency and gridlock costs the region roughly $6 billion in lost productivity annually – a number which would rise to $15 billion by 2031 if nothing is done. This congestion also leads to ill health effects.
- A still-sizeable infrastructure deficit – along with a world-class transportation system, other areas of physical infrastructure, including water, wastewater and sewer systems, require significant investment, up-keep and funding for operations in order to sustain future growth and quality of life in the region. Much of the tab for infrastructure falls on the doorstep of municipalities. Yet, these jurisdictions have lacked fiscal and administrative flexibility to adequately tackle their challenges.

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- An ageing workforce and slower population growth – the lower labour force participation of ageing baby boomers compared to younger cohorts will put a growing damper on the region's income-generating capacity, while an ageing population will put upward pressure on health care expenditures. Newcomers, who will continue to be relied upon to power population gains, are increasingly looking to other destinations to reside. The Toronto region's share of national immigrants has declined to 34% from 44% in 2006. Lastly, as further highlighted during the current recovery, there is a persistent challenge of newcomers' ability to take advantage of labour market opportunities.
- Weakened cost competitiveness – despite a number of positive moves to reduce the business tax burden, the mix of a strengthening Canadian dollar and downward pressure on wages in competing U.S. states has left many businesses in the Toronto region struggling to compete. Furthermore, in light of federal and provincial deficits, there is a real risk that at least some of the progress recorded on the tax front could be reversed.
- Too few opportunities for youth – the Toronto region boasts a relatively high rate of post-secondary education attainment. However, the higher education system in Ontario is not well integrated with employer needs and private training expenditures are relatively low, leaving many youth in the region unemployed or under-employed. These trends contribute to other less-than-desirable social outcomes, including increased poverty, civic disengagement and higher crime rates than what would otherwise be the case.
- Too many marginalized residents – despite a decent economic recovery since the recession, many residents in the Toronto region have been left behind. The income security system is an integral part to ensuring a social safety net is present in a time of need. However, the current system is too complex and erects a number of barriers to making work pay. Despite the boom in new home construction, the supply of purpose-built affordable housing has not increased in line with demand in recent years.
- Environment has declined in priority – there has been progress on the environmental front in the past decade, including fewer smog days and reduced carbon emissions from electricity generation. Nonetheless, since the financial crisis, the urgency to take action to improve the environment has waned as focus within North America has turned to the economy. Southern Ontario is already beginning to experience an array of climatic changes ranging from increasing temperatures to erratic precipitation, which will require adaptation strategies.

Economic and fiscal backdrop complicating factors

Efforts to strengthen the economic and social foundations of the Toronto region going forward will be complicated by the economic and fiscal backdrop that is likely to prevail over the next 3-5 years. Economic growth in recent years has been bolstered by some unsustainable trends – most notably, ultra-low interest rates, excessive household borrowing and over-valuations in housing. An expected reversal of these imbalances is likely to leave the pace of annual economic expansion in the region running at a modest 2% rate, well down from the economy's historical 3% cruising speed.

Furthermore, the federal and provincial governments have been staying the course on plans to gradually eliminate their deficits. A healthy government fiscal position is critical to the region's fortunes over the long haul. However, the current attention placed on eliminating budget shortfalls will reduce governments' medium-term wiggle room to further invest in important policy areas. Meanwhile, municipalities in the region will also face an increased financial squeeze from a cooling in housing market activity, downward pressure on federal and provincial grants, and pressure to take up slack in areas where other levels of government have reduced support.

Not only are public resources likely to be limited, but a catalyst to spur immediate change such as an economic crisis is absent. This creates a significant leadership challenge.

Considerations for action

In order to move the region forward in this modest growth, fiscally-constrained environment, there needs to be more energy placed into key priorities based on a number of core considerations. We highlight a number of them in the text box on the next page. Initiatives that bring together the region in a cohesive way, manage to tackle multiple economic and social objectives but don't result in negative unintended consequences offer the most potential to achieve positive change. Above all, an over-arching requirement that needs to carry special weight in deciding policy actions is addressing the Toronto region's weak productivity performance. This is because increased efficiency and higher productivity is the most important driver of higher living standards over the long run.

A focus on doing more with less would involve the notion that governments focus their attention on those residents that need help the most. To the extent that new revenue-raising measures are required, emphasis needs to be placed on those sources that inflict less damage to economic growth and competitiveness. Such a shift will require innovative funding approaches in areas which offer large net benefits and where broad support across the region can be galvanized.

It's time to move on the Big Move

There are a number of areas that would satisfy these various conditions. One that stands out in our view – and a core theme of the upcoming Forum – is the need to transform Toronto region's transit and road system from a relative disadvantage into a significant advantage. Transportation is a lifeline of an economy. Yet, as we noted previously, traffic gridlock carries a heavy price tag in terms of lost productivity to the Toronto region. An inadequate transit system is costly in terms of reducing mobility of people, including cutting off those in poverty with job opportunities, as well as business. It also forces people into their cars to the detriment of the environment.

The regional transportation authority, Metrolinx, has issued an ambitious plan called "The Big Move" that would mark a major step forward. The plan will require funding of some $50 billion for capital outlays over 25 years and $1.5-2 billion in annual operating expenses. With government coffers already stretched, there is an increasing recognition across the public and private sectors that new revenue tools will need to be implemented in order to make the Big Move a reality. By June 1, Metrolinx will release its long-awaited proposals for funding its investment strategy. Options on the table include a sales tax, highway tolls, a parking space levy among others.

Considerations for future action

- Priority setting critical;
- Discussion should be regional in focus, not municipal;
- Best approaches tackle multiple economic/social objectives;
- Policies should be looked at through a productivity/efficiency lens;
- Avoid measures that create large unintended consequences;
- Reap the benefits of strong collaboration and involvement of the private sector;
- Recognize that the competition does not stand still.

In a number of reports released over the past decade, TD Economics has come out in favour of the efficient and transparent use of road pricing and/or a regional sales tax levied in the commuter area to help fund key local services such as transportation. We continue to support this position. Measures taken through the income tax system could help to mitigate the impact of the higher cost on lower-income households.

Bottom line

Notwithstanding financial problems globally, the Toronto region has recorded solid gains in living standards since the Great Recession. Still, building on this relative success over the next five years in what is likely to be a slow growth, fiscally-constrained environment will not be easy. The best chance of success is likely to revolve around finding areas of common challenge across the region and where residents perceive a significant payback in terms of economic benefits and improved quality of life. After years of talk, developing a world-class transportation system of the 21st century could be one major initiative that finally sees its day in the sun.

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