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Government
of Canada

Gouvernement
du Canada

Regional Industrial
Expansion

Expansion industrielle
régionale

Canada

Ontario - 1988

An Economic Perspective

DEPARTMENT OF REGIONAL DEVELOPMENT

EXECUTIVE SUMMARY

In the sixth year of expansion, the Ontario economy is approaching full capacity in many of its sectors. The growth has been part of a broad international economic recovery. A combination of natural advantages and a favourable economic climate - good exchange rates, expansionary fiscal policy and a freer energy market - has generated this growth.

During the expansion, a significant amount of restructuring has occurred. A greater portion of output now flows to foreign markets, while a relatively smaller share is sold interprovincially. Automotive exports to the U.S. have been a major factor. The strong foreign demand along with domestic demand for residential and commercial construction have provided a major stimulus to the goods-producing industries where much of the growth has transpired. As a result of a significant improvement in productivity, these industries have increased output but not created many jobs. The service industries, on the other hand, have produced net increases in employment, but with the exception of business services, experienced little growth in output.

This growth and adjustment process is helping to bring Ontario's economy in line with the new realities of international competitiveness and global marketing. Weaknesses in labour force training, technology diffusion, and investment in R&D and fixed capital, however, remain limiting factors. The ability to remain competitive in terms of cost and quality, to identify market niches and to adjust rapidly to changing international conditions will be critical to the province's future potential for growth.

Growth brings its own problems. In Ontario, the risk of inflation is real. The regional distribution of growth has been uneven, favouring the Greater Toronto area. It has created pressures on health, educational and welfare services, along with housing, as considerable population shifts have occurred in response to new job opportunities. These demands, along with those on municipal infrastructure, are creating severe financial problems for local and regional governments. The concentration of the growth in a few key and primarily internationally-traded sectors -- mineral and forestry industries, autos, construction and business services -- has made the economy vulnerable to downturn.

The immediate challenge to private and public sector managers is to consolidate, sustain and broaden the benefits of expansion, while alleviating the pressures of operating at a high performance level. Over the longer run, the challenge is to expand the range of economic activities that are internationally competitive and to maintain a flexible economic framework.

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ONTARIO - 1988

AN ECONOMIC PERSPECTIVE

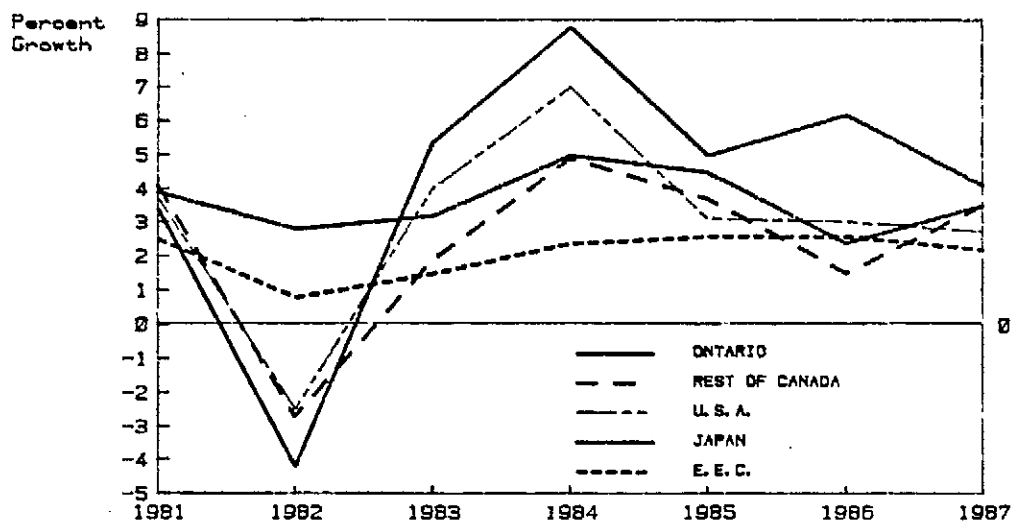
Ontario is now in its sixth year of uninterrupted economic expansion. During this period, Ontario has outperformed all the major industrial nations. Structural analysis indicates widespread adjustment in the province's employment, output and markets. Speedy adaptability to new opportunities, competitive challenges and changing market conditions have been key ingredients to the province's growth and prosperity.

This paper examines the recent performance of the economy. As prolonged growth often produces significant shifts in the economy's structure, the analysis will examine the distribution of Ontario's recent expansion. The recovery will be addressed in the context of international events and the longer-term economic cycle. The paper concludes with implications for future economic development and the identification of constraints.

ECONOMIC PERFORMANCE

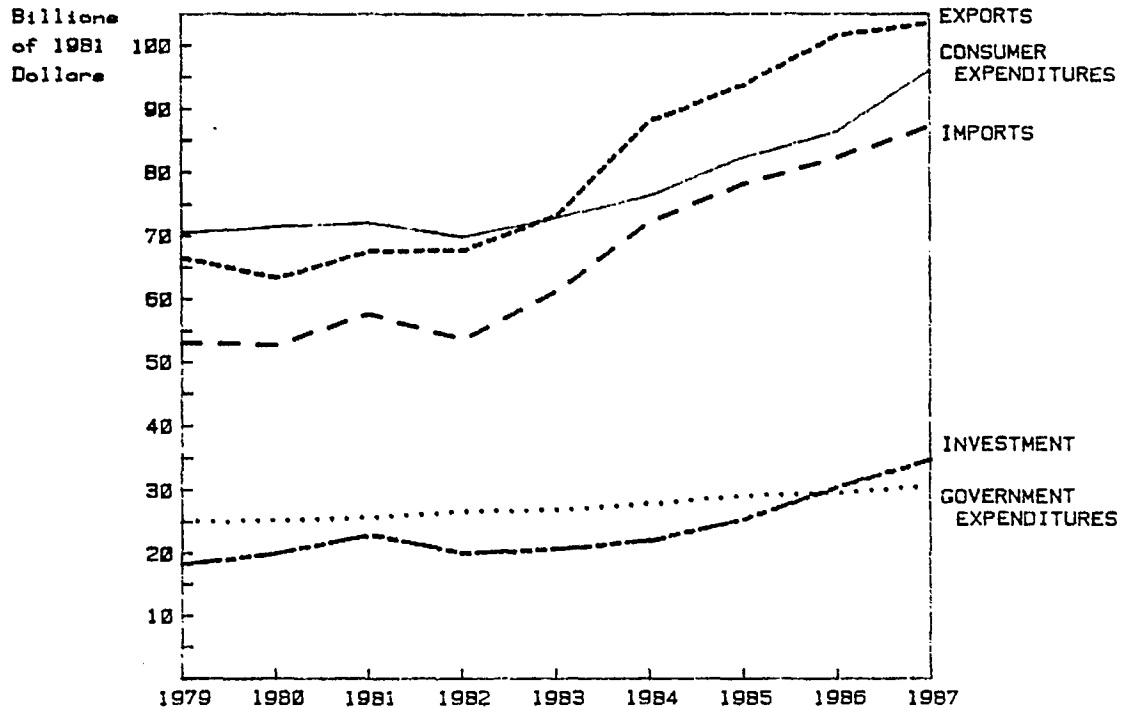
Since the 1980-82 recession, Ontario's economic growth has averaged an impressive 5.9% in real terms. The 1988 performance, reflecting a maturing of the economic cycle, appears to be somewhat slower. Indicators suggest a 3.7% increase in the current year.

CHART 1: GROWTH IN REAL DOMESTIC PRODUCT, 1981-87.



The primary forces behind this sustained growth have been consumer spending and export demand. Demographic trends have triggered major residential investment and purchases of durable goods as the baby-boom cohort has moved into the household formation stage. The strong propensity to consume has also been a driving force behind the rise in imports. Presently, strong business capital formation is helping to sustain the expansion, while also contributing to the strength of imports.

CHART 2: COMPONENTS OF ONTARIO DEMAND, 1979-87.



At this point in the business cycle, Ontario's economy appears to be moving close to full employment. Since 1982, 639,000 net new jobs have been created - a 15.7% increase in the number of people employed. Real output has grown by a third, while manufacturing capacity utilization has climbed to 95.3% from 80.5%.

While Ontario is enjoying a strong recovery, the benefits have not been evenly distributed. Communities in south central Ontario are enjoying the greatest growth. Approximately 50% of new jobs are within a 60-mile radius of Toronto, where the unemployment rate averaged 4.5% throughout 1987. By contrast, the northeastern Ontario communities of North Bay, Sudbury and Sault Ste. Marie had unemployment in the 11% range. There are, moreover, significant income differentials in southern Ontario. Ottawa and the satellite communities around Metropolitan Toronto enjoyed median incomes 15% to 20% higher than the 1986 provincial average. By contrast, the cities of Cambridge, St. Catharines and Brantford had incomes 6% to 11% under the average. As the sectoral analysis below will show, rural agricultural areas have not fully shared in the expansion. There have been significant narrowings of wage and employment gaps in eastern Ontario.

ANALYSIS

a) The Growth in Context

Ontario has experienced a lot of growth since 1982 which has resulted in structural changes. But, it has not been alone. The province's growth has been part of an international economic recovery which the province was well-positioned to share due to the types of goods and services it exports. Inherent advantages of location, highly developed financial services, modern transportation and communications networks and excellent local infrastructure have assisted Ontario in attracting new investment and in entering new markets. Favourable exchange rates and improved commodity prices have also combined with other factors to create a climate suitable for growth, notably:

- . the resurgence of North American automobile demand as a result of reductions in fuel prices;
- . expansionary fiscal policy based on deficit financing throughout North America that was accommodated by inflows of foreign capital;
- . a blend of supportive tax and industrial development policies which encouraged investment and business expansion.

b) Sectoral Performance

The recovery has been most dramatic in the goods-producing sectors, although some of this represents a return to pre-recession levels of output¹. In contrast, agriculture has expanded at only half the rate of the overall economy. Weak field crop prices in wheat, corn, soya beans - due to international oversupply - and tobacco have slowed this sector. Residential investment advanced construction activity by one-half, while manufacturing registered a healthy gain of 42% based on both strong domestic and foreign demand.

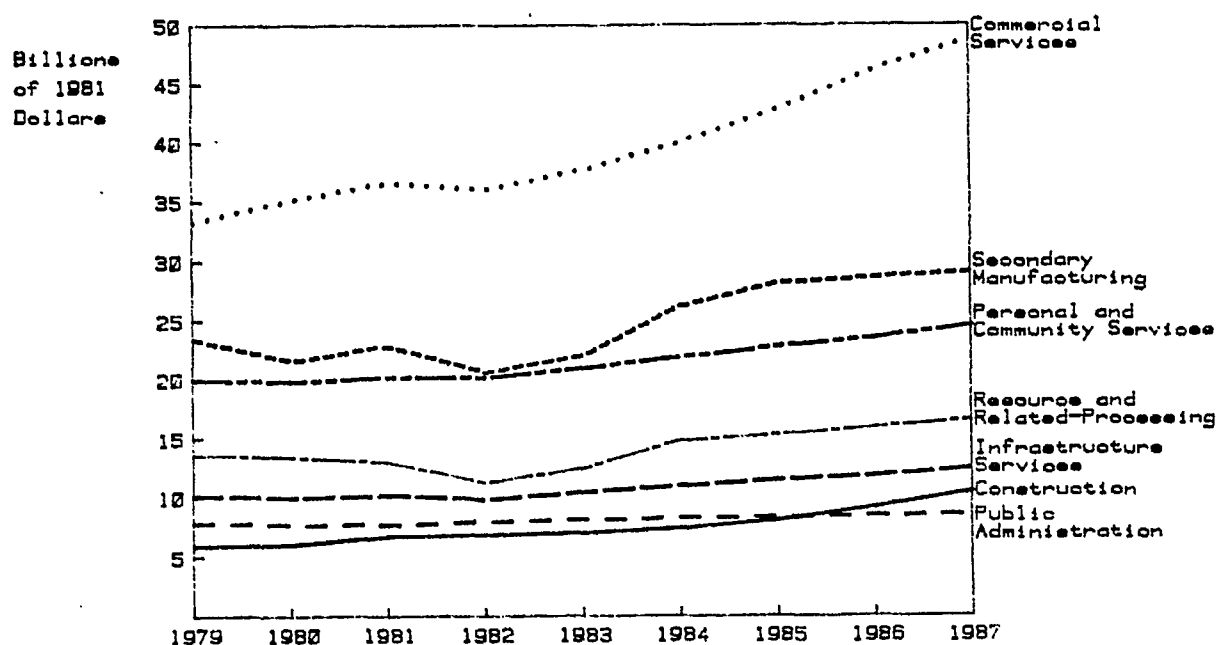
Within the manufacturing sector, mineral and forestry processing, along with auto production, have doubled their output. The healthy transportation equipment industry had positive spinoffs for metal fabricating, rubber and chemicals. On the weaker side, the food and beverage industry has shown the slowest growth, to compound the relatively weak performance in the agriculture sector.

Among the service sectors, only commercial services² achieved the growth rates exhibited by the stronger goods-producing industries. Government spending restraint has limited the growth of the community service and public administration sectors.

¹ Within these industries, 60% of the 157,000 net new jobs and 25% of the expanded output since 1982 has involved rebuilding recessionary losses. With the exception of infrastructure services - transportation, communications, storage and utilities - there were no similar losses in the service sector.

² Includes business services, finance, insurance, real estate and wholesale trade.

CHART 3: REAL DOMESTIC PRODUCT BY SECTOR, 1979-87.



c) Market Developments

The recovery period has brought a restructuring of Ontario's markets. Foreign consumption has risen, driven by the large automotive exports to the United States. Offsetting this trend has been the relative decline of sales to other parts of Canada. As a result, U.S. automotive sales now outweigh total sales of goods and services to the rest of the country. The relative decline in sales to non-U.S. markets has also been significant. The earlier appreciation of the Canadian dollar against many industrialized currencies as well as the slower recovery in Europe and Japan have contributed to this slower growth in overseas markets. Consumption of output within the province continues to hover around the 50% mark.

Table 1: Distribution of Ontario's Output 1979-86 (Percentage)

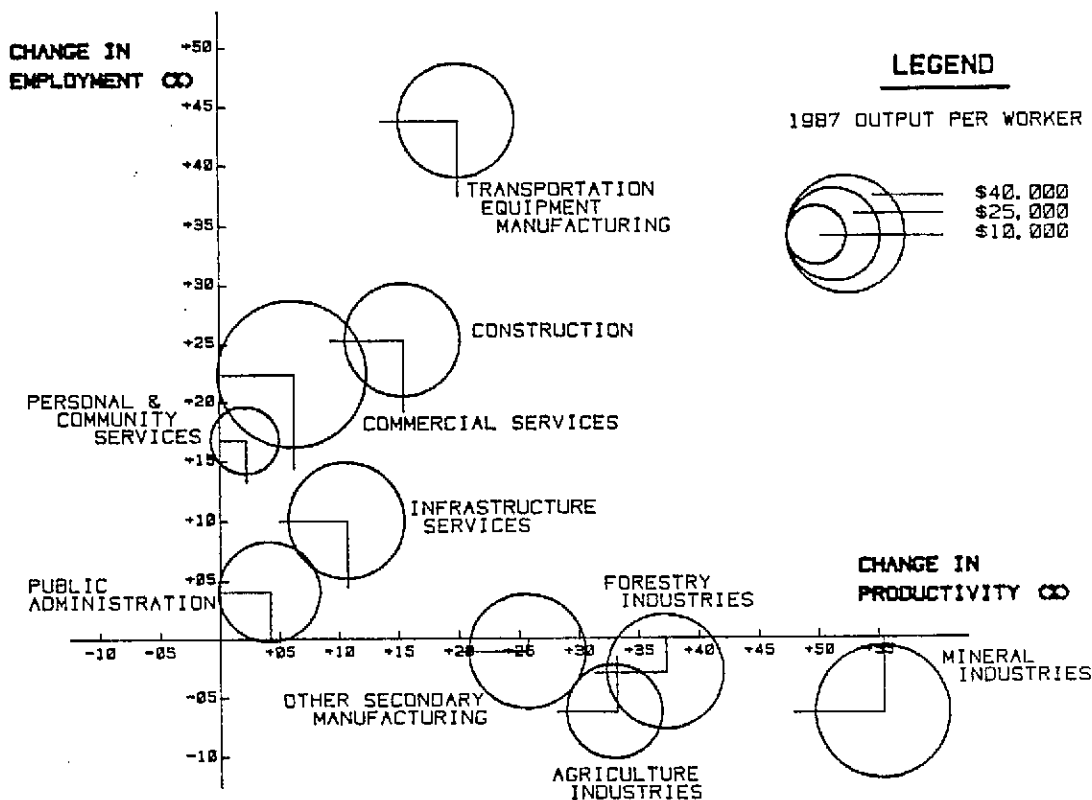
Year	Consumption in Ontario	Sales to the Rest of Canada	Foreign Exports			Total Exports
			U.S.A.		All Other Countries	
			Auto-motive	Other Goods & Services		
1979	47.1	22.6	11.0	13.6	5.7	30.3
1980	48.0	21.3	9.2	14.5	7.0	30.7
1981	48.7	20.4	9.9	14.5	6.5	30.9
1982	49.7	18.7	12.7	13.5	5.4	31.6
1983	50.5	17.7	14.9	13.3	3.6	31.8
1984	45.7	17.5	18.4	14.7	3.6	36.7
1985	46.0	17.1	19.3	14.5	3.1	36.9
1986	48.3	15.9	18.0	13.9	3.9	35.8

d) Labour Markets

While the goods-producing sectors have registered the strongest output performance, three-quarters of the job creation has occurred in the service sector. This asymmetry seems to be related to the discipline of international competitiveness. While many services escaped the recession unscathed, the resource and manufacturing industries were confronted with painful downsizing. Subsequently, they have improved productivity thereby regaining competitiveness.

Chart 4 portrays this relationship between employment growth and productivity improvement. Most goods-producing industries are clustered along the horizontal axes, indicating declines in employment along with strong improvements in output per worker. The exceptions are transportation equipment manufacturing and construction, where large employment increases have been associated with the expansion of output. The non-goods sectors, for their part, are clustered along the vertical axes, which denotes increases in employment but only modest growth in output per worker. The size of the circles in the chart indicates the relative levels of output per worker. Commercial services is the highest (\$63,960) and personal and community services the lowest (\$13,300). Generally, increased employment in sectors with large circles is desirable, as they offer opportunities for higher incomes and improved competitiveness.

**CHART 4: STRUCTURAL ADJUSTMENTS IN ONTARIO
ECONOMIC SECTORS, 1981-82 to 1986-87.**



CONSEQUENCES OF GROWTH

a) Competitiveness and the Global Economy

The province's increasing penetration of foreign markets underlines the importance of international competitiveness. The ability to find market niches, to remain competitive and to adjust rapidly to changing international conditions is becoming more critical. The general trend towards outward-looking businesses and the globalization of markets are well documented in both the Macdonald Royal Commission Report and the work undertaken by the Ontario Premier's Council on the Economy.

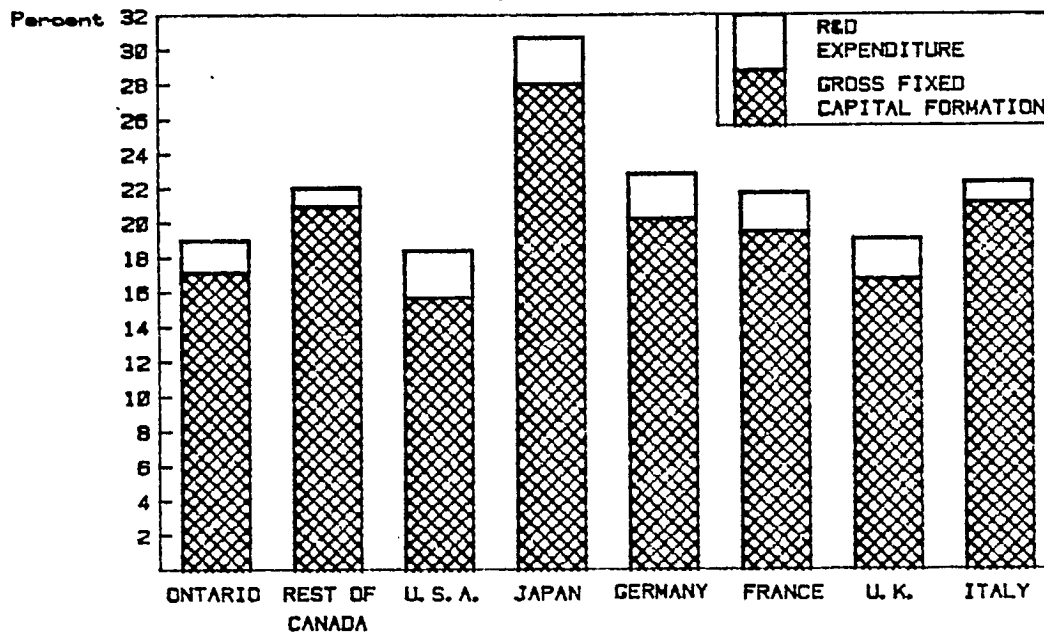
Structural changes in Ontario's population as the baby-boom cohort continues to age is expected to introduce fundamental changes to market demand. As this group moves out of the household formation phase over the next few years, consumption patterns are expected to shift away from housing and consumer durables in favour of more services. Economic planners suggest that a further penetration of foreign markets may be one alternative to offset the loss of demand for durable goods, once again emphasizing the importance of external markets for Ontario.

The province's high labour costs relative to the newly developing nations, competition from Third World countries in traditional resource-processing sectors and sophisticated domestic demand are increasingly forcing Ontario entrepreneurs to search for opportunities in the capital-intensive, high-tech activities. This often means being competitive against such countries as the U.S., Japan and the EEC countries. Comparative analysis suggests significant scope for improvement. Relative unit labour costs for manufacturing as a whole reveal Ontario currently suffers a disadvantage relative to the U.S., France and the U.K. The strengthening Canadian dollar could weaken this position further. Moreover, Ontario's level of gross fixed capital formation and R&D investment as a percentage of GDP has generally been below the levels of the highly industrialized countries. The slowness of technology diffusion, relative to other countries, has been identified as a further problem for Canadian industries in the Macdonald Royal Commission Report³.

³ McFetridge, D.F. & Corvari, R.J. "Technology Diffusion". Tech-
nology Change in Canadian Industry, Vol. 3. Toronto: University
of Toronto Press, 1985.

CHART 5: GROSS FIXED CAPITAL FORMATION and R&D EXPENDITURE

(as percents of G. D. P., 1983-85)



b) Structural Flexibility

One important conclusion emerging from Ontario's strong performance is the economy's proven ability to adjust to changing conditions and new market demands. Just as recession induced a rationalization process and a 50% rise in bankruptcies, recovery has witnessed a near doubling of new business formations.

In the labour market, too, the magnitude of the response to changing opportunity is impressive. Individual shifts between employment, unemployment and labour force entry and exit involved about 425,000 changes per month during 1987.

For some industries, adjustment to the new competitive environment has meant growth without new jobs. In the north, many forestry and mining enterprises have actually cut jobs while carrying out substantial capital formation. This was undertaken to protect market share in the face of competition from new Third World producers.

c) Diseconomies of Growth

i) Congestion

Prosperity and jobs are attracting substantial international and out-of-province migration, especially to the Greater Toronto Area. Ontario's share in Canada's total population climbed from 35.4% to 36.2% between 1981 and 1987 and the labour force participation rate increased from 67.3% to 68.9%. Presently, 56% of immigrants settle in Ontario, two-thirds of these in Toronto.

Table 2: Components of Ontario's Population Change, 1981-87
('000)

Year	Population Increase	Natural Increase	Net Interprovincial Migration	International Immigration	International Emigration
1981	61.4	60.4	-33.2	54.9	20.7
1982	91.1	60.1	- 5.7	53.0	16.3
1983	109.0	62.0	23.6	40.0	16.6
1984	117.0	63.6	36.4	41.5	24.5
1985	118.2	65.6	33.9	40.7	22.0
1986	120.0	66.1	33.6	49.2	28.9
1987	157.7	N/A	N/A	84.7	N/A

Note: Ontario population in July 1, 1987, equalled 9,270,700.

The influx of people is straining Ontario's social welfare, health and educational systems. Welfare costs for refugees alone are costing Metro Toronto \$40 million annually. The province, in its recent budget, allocated \$3 billion of new funding for social programming - a 10% increase. Housing shortages and spiraling costs are threatening to cause problems in many central Ontario communities. These conditions are reflected in the mid-March Decima survey, which shows social service and housing issues displacing more traditional economic problems as issues of public concern.

ii) Uneven Growth

The vibrant performance of the Greater Toronto Area, with its large market, diversified economic base and ready access to capital and skilled labour, differentiates it from the rest of the province. Outside the Toronto area, the expansion has been strongly skewed to urban centres and has not been shared by rural agricultural areas. In the north, expansions in the resource processing sectors have not been mirrored by increases in employment opportunities.

According to recent statements by the Ontario Association of Municipalities, the maintenance and development of infrastructure in many communities is not keeping pace with local expansion. Public sector services related to health, education, welfare and housing are increasingly hard pressed to keep abreast of the growth in the private sector.

Since the expansion has not been broadly based throughout the economy, prospects for maintaining and extending the current levels of output are problematic. Mining, construction, mineral processing, lumber and the automotive trade have been the principal engines of recovery. Resource processing and export activity is vulnerable to an international downturn, while automotive demand is traditionally cyclical and threatened by rising competition from foreign producers.

d) Labour Shortages

As the period of recovery lengthens, a growing number of shortages of skilled labour are appearing. Canada Employment and Immigration has identified 108 occupational groups as being in critical short supply, primarily in manufacturing, mining, construction and business services. The number of identified occupational shortages has doubled in the past three years. In northern Ontario, for example, there is currently a reported need for large numbers of hard rock miners. An Ontario Government study also forecasts an overall labour shortage during the next 10 years, based on the changing age profile of the population.⁴

Employers have been critical of the general quality of education of the work force⁵ and point out that this inhibits their ability to undertake retraining and move into high-tech sophisticated markets.

e) Inflationary Pressures

Extended periods of growth may lead to inflationary pressures as various segments of the economy begin to approach or exceed full capacity utilization. This is a concern now in Ontario, particularly in the Toronto area. The city's annual 1987 consumer price index (CPI) stood at 5.6% as opposed to 4.4% nationally. Recent wage settlements in the province's large commercial construction industry have been in the 6% to 7% range. In the face of strong demand, housing and land prices have risen.

IMPLICATIONS AND CONSTRAINTS

Ontario's growth since the 1981-82 recession has been impressive. Growth, however, brings its own problems and can leave a widening gap of opportunities within an economy. As the provincial economy moves closer to full employment, the threat of an outbreak of inflation becomes increasingly real and a potential constraint to future development. These are all valid concerns for policy makers. Initiatives that would consolidate, sustain and broaden the benefits of the expansion, while alleviating the pressures of operating at a high level of performance would be welcome at the present time.

The pressures on housing, local infrastructure and health, educational and welfare services being experienced today are by-products of growth and prosperity. The provincial and local governments faced with these expanding demands are asking for increased federal transfers. While the expansion continues, Ottawa will be under rising public pressure to assist in meeting these needs. Involving the private sector in resolving these issues will be a continuing challenge.

⁴ Ontario Ministry of Skills Development. Adjusting to Change: An Overview of Labour Market Issues in Ontario. Toronto: Queen's Printer, June, 1988.

⁵ Premier's Council. "Competing in the New Global Economy", Report of the Premier's Council, Vol. 1. Toronto: Queen's Printer, 1988.

In the context of the present economic restructuring, the Ontario government is active in generating public discussion about the province's long-term challenges and opportunities as it charts new directions and goals for the economy. The Premier's Council on the Economy, established in April 1986 as a multipartite advisory body, has been examining the key issues of adjustment, competitiveness, skills training, entrepreneurial development, research and development, risk-sharing and economic cooperation in an international context. A second group, the Premier's Council on Health Care, has recently been established to examine a number of the health issues, infrastructure requirements and costs. This work has direct implications for Ottawa. It will be necessary for the federal government to monitor the process, devise appropriate policy responses and join in cooperative initiatives.

An area of particular concern for both levels of government continues to be training and skills development. While the present training system has facilitated adaptability and substantial re-deployments during the current expansion, this training system will need to be strengthened to keep up with rapid change. With anticipated slower overall labour force growth over the next decade, labour market intelligence must be perceptive, and training programs should be widely available and rapidly responsive.

The key to Ontario's continuing development and growth appears to depend on maintaining and facilitating the adjustment process. While the private sector has demonstrated an ability to adapt to new market opportunities and meet competitive challenges through productivity improvements, Ontario's future unmistakably lies in being internationally competitive and participating in the further globalization of trade. How can the provincial economy better exploit its advantages of location, resources, infrastructure and business support services? Can it broaden its base of economic activities that are internationally competitive? Will it be able to sustain a high level of commitment to the adjustment process? These are fundamental challenges confronting the provincial economy today and into the future.

