

More Harm Than Good

Austerity's Impact in Ontario

Trish Hennessy and Jim Stanford





CCPA

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Executive Summary

THIS REPORT PROVIDES a detailed overview of economic and fiscal indicators to assess how Ontario fared during the recession of 2008–09 and how the province is doing during the long climb back to economic recovery.

It finds that during the worst of the recession, Employment Insurance (EI) and social assistance programs — once considered automatic stabilizers during economic downturns — failed to provide the safety net that they did in previous recessions. In fact, EI coverage in Ontario has reached its lowest point in history. Meanwhile the Harris-era barriers to gaining access to social assistance remain steadfastly in place.

This report finds that on many measures — the employment rate, the number of long-term unemployed, underemployment, and youth unemployment — the province has not yet returned to pre-recession benchmarks. It finds some of the province's hardest hit communities continue to struggle to create new jobs and bring down unemployment.

While youth unemployment remains twice as high as the province's overall unemployment rate, at the other end of the age spectrum, the number of Ontario's working seniors has tripled since 2001. Some of the biggest increases in senior employment have occurred in retail trade, accommodation and food services — traditionally entry-level jobs for youth.

The report also draws on new Statistics Canada data that shows Ontario is experiencing among the worst increases in income inequality, second only to Alberta. The richest 1% in Ontario now receives, on average, 16 times

more than those who belong to the bottom 90%. Thirty years ago, that ratio was only 10 times more.

The report examines the fiscal assumptions underlying the province's focus on speedy deficit reduction and finds them to be based on faulty methodology and manipulative data. The report ends with a warning: the provincial government's sudden and unjustified shift to austerity in 2012 is already contributing to a slowdown in economic growth. Provincial program spending in Ontario declined by close to 1% of provincial GDP between 2009 and 2012, at a time when federal and municipal program spending was also being constrained – creating a “triple threat” of austerity. The report estimates the direct and indirect effects of such fiscal reductions could reduce Ontario's GDP by a total of 3% over the next couple of years.

Unless other economic engines are strongly in gear, the multiplied contraction resulting from fast and deep program spending cuts could easily pull the provincial economy back into recession. The report concludes that a misplaced focus on deficit reduction ahead of other priorities – a full jobs recovery, reducing income inequality and poverty, and investing in public infrastructure – will clearly do Ontario more harm than good.

Introduction

FIVE YEARS AFTER a global economic meltdown dragged Ontario into recession, the province is still traversing a slow and winding road to economic recovery. The recession officially ended in Ontario in the summer of 2009, but recovery has been elusive, in Ontario but also elsewhere in the world. An ill-advised emphasis on austerity has stifled growth and, in some countries, even pushed their economies back into recession.

In Ontario, concern bordering on deficit hysteria reached its peak with the release of the Commission on the Reform of Ontario's Public Services, known as the Drummond report, in January 2012. The Drummond report predicted an exploding deficit that would soon exceed \$30 billion. To avoid what was framed as a catastrophic fiscal meltdown, the Drummond report recommended an extensive austerity agenda of public service cuts, layoffs, and privatization.

In last year's budget, the Ontario government set the wheels in motion to adopt many of the report's recommendations, focusing myopically on deficit reduction regardless of austerity's negative economic and social side effects. The evidence reveals those projections were wildly overstated — the official estimate of the 2012–13 deficit is now \$11.9 billion,¹ \$3 billion less than projected just a few months ago, and barely one-third Drummond's doomsday forecast.

This report examines the state of the province on fiscal, economic, social fronts. It shows how Ontario has not yet returned to pre-recession levels of employment and economic activity: there is still significant unused

or underemployed productive capacity. It presents evidence that the single-minded focus on Ontario's fiscal deficit has diverted the province's attention away from the role government can, and should, be playing to ensure complete recovery from the recession that triggered the deficit in the first place. The report shows the province has far greater fiscal capacity than the dominant narrative allows, and it flags potential risks for Ontario if it continues along the austerity path it suddenly started down a year ago.

Slow Road to Economic Recovery

INITIALLY, ONTARIO WAS on a fragile road to recovery following the Great Recession of 2008–09. Economic growth had spun around, from a drop of -3.2% in 2009 to an expansion of 3% in 2010. Then came the first inkling of austerity budgeting, as federal and provincial stimulus spending was quickly wound down. In 2011, economic growth slowed to 2.1%. It's expected to stall at 2% in 2012² and the expectation is for further slowing in 2013.

The slowdown in Ontario's economy and labour market reflects a similar deceleration in Canada's performance. National economic growth was barely above zero in late 2012 and the economy began shedding jobs again in early 2013 (22,000 in January 2013). Combined with weak housing starts and a shaky global economic situation, the gathering clouds suggest Ontario's economic recovery remains on fragile ground.

1. Recession's Impact³

1.1 Unemployment

As recessions are wont to do, the 2008–09 recession had a significant impact on Ontario's labour market. Many Ontario workers found themselves side-

TABLE 1 Ontario, Gross Domestic Product, 2006–12

	2006	2007	2008	2009	2010	2011	2012 Q1	2012 Q2	2012 Q3
Real GDP (chained \$2002) Billions	523	533.2	529.8	512.7	527.8	538.8			
GDP Annualized Growth Rate	2.4	2	-0.6	-3.2	3	2.1	2.4	2.4	0.4

Source: Ministry of Finance, Ontario 2012

lined — and many remain so. Ontario’s unemployment rate was still 7.8% at the end of 2012, up from 6.5% in 2008 before the recession struck in full force.⁴ By 2010, over 150,000 Ontarians were counted among the province’s long-term unemployed — more than double pre-recessionary levels. As Figure 1 shows, this number has declined only slightly since then.

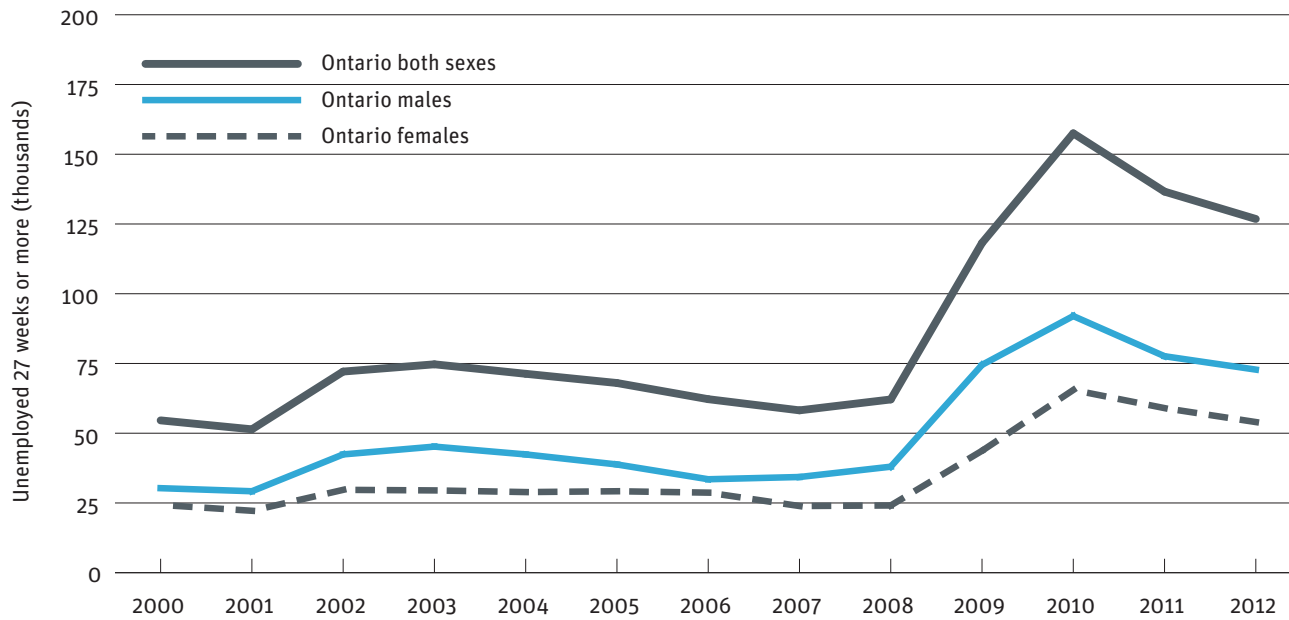
1.2 Ontario’s Employment Rate

The unemployment rate, however, can be a misleading indicator of labour market conditions, especially during times of labour market weakness. This is because many unemployed workers give up looking for work, given the dearth of employment opportunities. They then disappear from the official labour market statistics, which require an individual to be either employed or “actively” seeking work in order to be considered in the labour market. They’re often referred to as discouraged job seekers. Because the unemployment rate fails to capture discouraged and inactive job seekers, the *employment rate* is considered by many to be a better measure of labour market conditions. This measures the share of working-age individuals who actually have a job.

As Figure 2 illustrates, Ontario’s employment rate plunged from around 63.5% before the recession to just 61% by summer 2009 (when the recession ended — officially, at least). The employment rate then began a slow and uneven climb, reaching 61.6% in 2011. In 2012, however, the employment rate dropped back to 61.3%.⁵

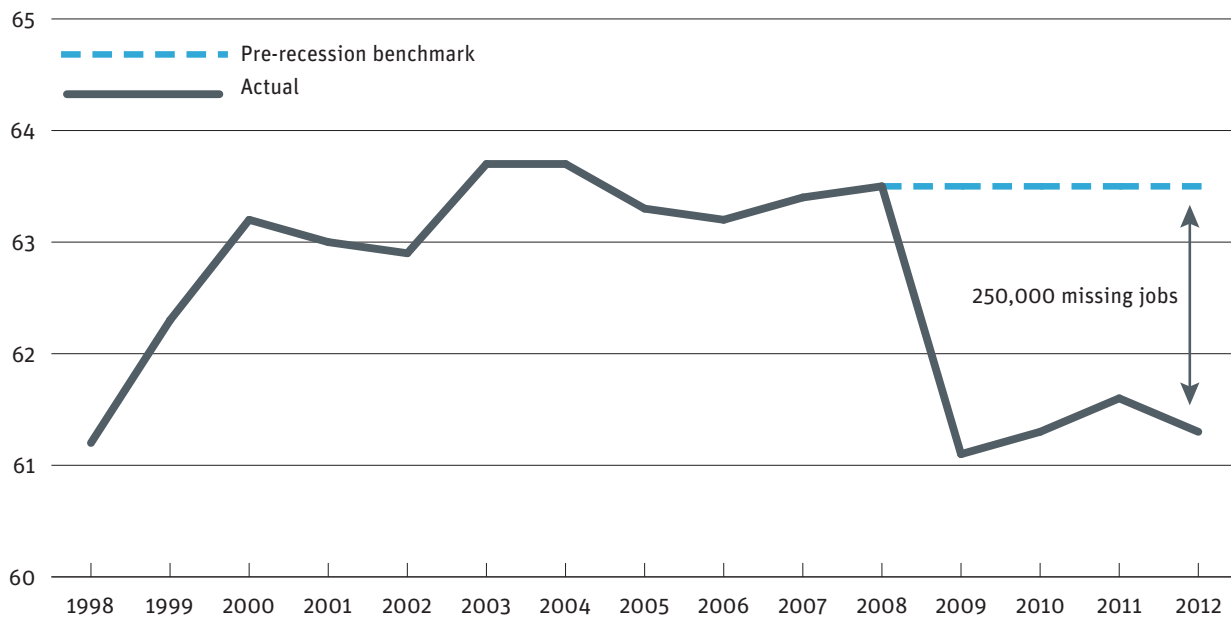
This means that the jobs created in Ontario’s economy were not even sufficient to keep up with provincial population growth — let alone to repair the damage from the recession. By this measure, Ontario’s labour market continues to experience conditions of underutilization that are almost as bad as during the worst days of the recession. Indeed, the gap between the current employment rate and the pre-recession benchmark corresponds to

FIGURE 1 Ontario's Long-Term Unemployed



Source: Statistics Canada, Labour Force Survey, CANSIM Table 282-0047

FIGURE 2 Ontario Employment Rate



Source: Statistics Canada, Labour Force Survey, CANSIM Table 282-0002.

the absence of 250,000 jobs in the province. For many Ontarians, clearly, the recession still hasn't ended.

1.3 Hardest Hit Sectors and Occupations

Some occupations in Ontario were hit harder than others during the recession, and some are rebounding more quickly than others.

Even before recession struck, Ontario's manufacturing sector had been experiencing massive job loss. The manufacturing sector has been shrinking rapidly since 2004, when it employed over 1.1 million workers. Recession didn't help matters, as the pace of job loss accelerated dramatically and employment in this important sector dropped to approximately 800,000 workers by 2012.

The occupations that experienced the greatest amount of job loss during the recession were largely related to Ontario's manufacturing sector. The province lost 25% of its estimated 390,000 machine operators — a loss of more than 100,000. An additional 108,000 workers in other occupations unique to manufacturing also disappeared. Job loss within the manufacturing sector has been mainly concentrated in large companies employing more than 300 employees, which shed more than 120,000 workers — or 27% of their workforce — compared to losses of 18% for medium-sized and 13% small-sized companies.⁶

Another shocking concentration of job loss was experienced in Ontario's forestry industry. Between 2006 and 2011, there was a decline of 75% of jobs in forestry and logging companies employing 300 or more workers.⁷

But what occupations have been experiencing the greatest amount of growth in Ontario? Between 2006 and 2012, there were an additional 148,000 workers in Ontario's sales and services occupations, made up of retail sales clerks, food and accommodation servers, cooks, etc. In fact, retail trade companies with 300 and more employees increased jobs by 41,458 employees — the second largest growth sector for employers with more than 300 workers, behind large health care employers.⁸ It's worth noting that while these sales and service jobs are with larger employers, many are precarious: they are contract, short-term, part-time, and shift work positions, and often the pay is low. Indeed, many of Ontario's minimum wage earners work in these jobs.

By this measure, Ontario's labour market is creating jobs that are insecure and don't necessarily pay well enough to even exceed the poverty

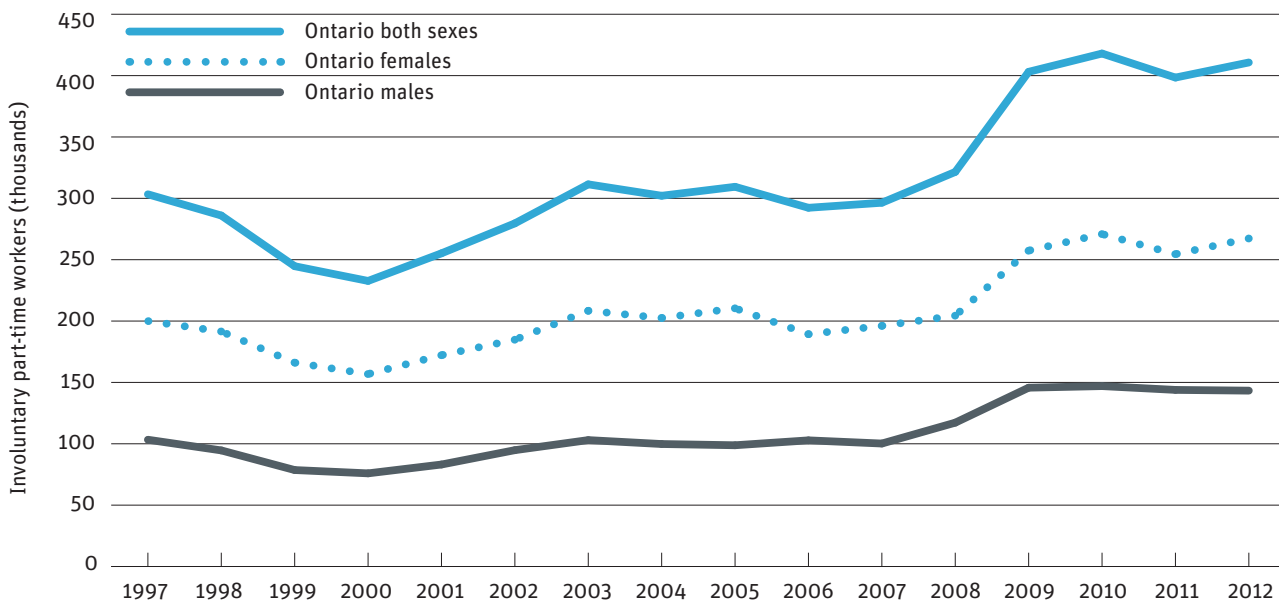
line. Other indicators of declining job quality compound this problem, as the next few sections illustrate.

1.4 Part-Time Vs. Full-Time Work

Similar to Ontario’s long-term unemployed, the number of people working part-time but wishing for a full-time job also grew during the recession. As Figure 3 shows, this measure (called “involuntary part-time employment”) has hardly improved at all since the worst days of the recession. Over 400,000 Ontarians are working part-time, even though they want and need full-time work.

In short, Ontario may have created new jobs in the post-recessionary period, but standard full-time employment is still inadequate to the needs of Ontario workers. The province appears to be in the midst of an extended stretch of chronic unemployment and underemployment.

FIGURE 3 Involuntary Part-Time Workers



Source: Labour Force Survey, Statistics Canada, Cansim Table 282-0014

TABLE 2 Unemployment Rate By Economic Region (2006 Census Boundaries)

Community	2008	2009	2010	2011	2012
Ontario	6.5	9	8.7	7.8	7.8
Ottawa	5	6.1	7	6.3	6.4
Kingston-Pembroke	6	8.3	8.1	7.3	7.3
Muskoka-Kawarthas	6.4	7.9	9.2	8.6	7.5
Toronto	6.9	9.4	9.1	8.4	8.6
Kitchener-Waterloo-Barrie	5.7	9	8.2	7.2	6.6
Hamilton-Niagara Peninsula	6.7	9.2	8.3	7.1	7.2
London	6.9	9.8	8.5	8.6	7.9
Windsor-Sarnia	8.4	11.9	10.7	8.9	9
Stratford-Bruce Peninsula	4.6	7.9	6.7	5.3	4.5
Northeast Ontario	6.1	9	8.9	7.8	7.3
Northwest Ontario	7.9	8.9	7.2	7.4	6.7

Source: Labour Force Survey, Statistics Canada, CANSIM Table 282-0060

1.5 Hard Hit Communities

Some communities and regions were harder hit by the recession than others. As Table 2 shows, Windsor suffered the biggest blow during the recession. That city's unemployment rate peaked at 11.9% in 2009, during the worst of the economic crisis. Unemployment is now at 9%, reflecting that city's ongoing struggle to reach pre-recession unemployment levels.

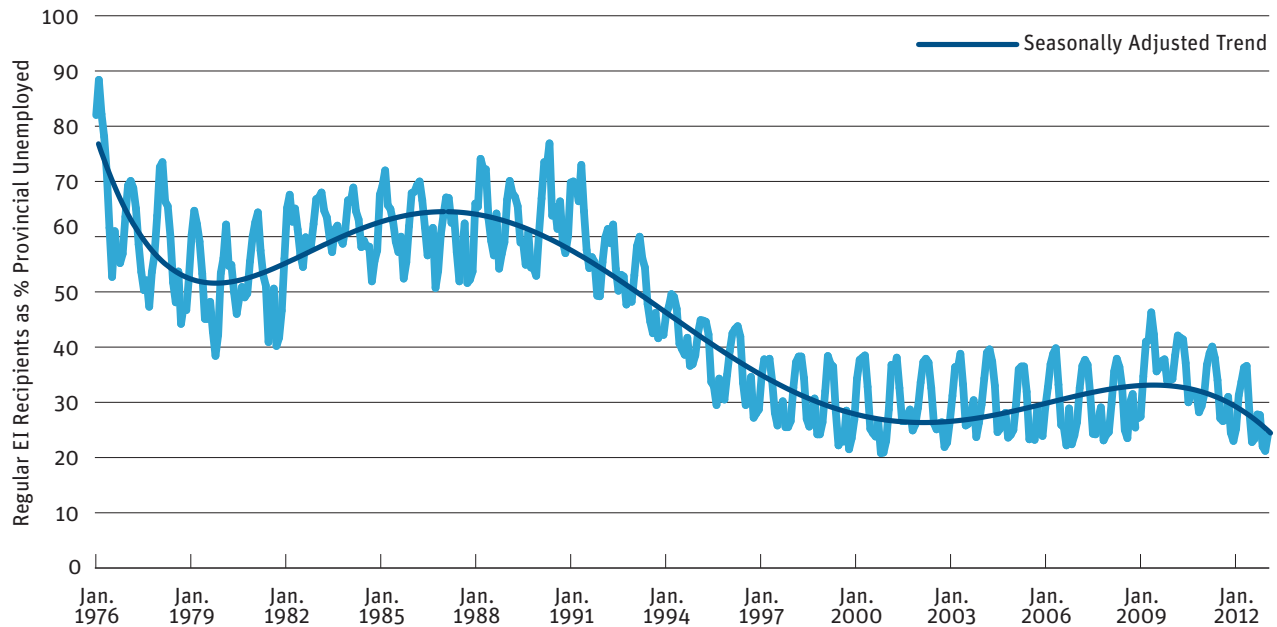
London and Toronto also experienced severe unemployment shocks in 2009, and in both cities joblessness remains higher than the provincial average.

It's clear from Table 2 that most communities are facing stubbornly high levels of unemployment. By this measure, most Ontario cities remain far from returning to pre-recession labour market conditions.

1.6 Employment Insurance

Canada entered into the global economic meltdown of 2008–09 with an Employment Insurance (EI) program that was completely insufficient for the task. Eligibility rules shut many of Ontario's unemployed out of the ability to qualify for EI, putting into serious question the 'insurance' promise of EI. Figure 4 illustrates that the number of EI claimants in Ontario (measured as a proportion of unemployed in the province) is at its lowest point in the history of EI.

FIGURE 4 Employment Insurance Coverage Rate, Ontario



Source: Statistics Canada CANSIM Tables 276-0001

In October 2012, only 21.2% of the province’s unemployed were receiving regular EI benefits: barely one in five. That means many of Ontario’s unemployed were forced to turn to social assistance or the help of friends and family, because their national insurance program was not there for them in their hour of need. There is a particular bias against women, who have a harder time qualifying for EI under the current rules; coverage rates for female unemployed workers are lower than male coverage rates. Fixing the EI system is a problem that needs to be addressed at the federal level; given Ontario’s uniquely low EI coverage rate, pushing for this change is an urgent provincial priority.

1.7 Youth Unemployment

The recession has also been harder on Ontario’s youth, especially young men. Male youth unemployment grew from 14.8% in January of 2008, peaking at 22.7% in December 2009 and inching downward to 19% by December 2012 — while the unemployment rate for young women remained at 15%.⁹ Youth unemployment in general tends to be higher than the overall rate, but it is currently twice as high as the overall provincial unemployment rate: standing at 17.1% in December 2012. Meanwhile, it has become harder for univer-

sity and college students to find a summer job. Student summer unemployment reached a 10-year peak during the recession; there has since been only minor improvement. Like many of the other indicators already discussed, youth and student unemployment still remains far above pre-recessionary levels. High student summer unemployment is undermining youth's efforts to gain experience in the work force and earn money to pay for tuition.

1.8 Seniors Heading Back to Work

At the other end of the age spectrum, labour force participation rate data shows the reversal of a 30-year trend: Ontario's pool of workers aged 65 and older has been rising. Between 1981 and 2001, the number of senior workers over the age of 65 remained stable, hovering near 70,000 — and representing a shrinking share of the senior population. Beginning in 2001, a different trend took hold, with a consistent increase in senior workers. By 2012, Ontario's working seniors had tripled in number. There are now an estimated 240,000 Ontario seniors over 65 in the workforce — about 12.5% of the total senior population.¹⁰ Some of the biggest increases in senior employment have been in retail trade, accommodation and food services — sectors which traditionally provide entry-level jobs for youth.¹¹

1.9 Income Inequality and Poverty

Against the backdrop of recession and tepid economic recovery, a neglected but troubling issue continues to stand out: income inequality in Ontario continues to worsen at a disturbing pace.

Much of the growth in income inequality in Canada is occurring because the richest households are breaking away from the rest of us. Ontario is no exception on this front; in fact, it is leading the way. As the CCPA-Ontario pointed out in January 2013,¹² new data from Statistics Canada shows Ontario holds the dubious distinction of having the second worst level of income inequality between the richest 1% and the rest of society — second only to oil-blessed Alberta.

Between 1982 and 2010, the top 1% of tax filers in Ontario saw their average income climb from \$280,000 to \$478,000 — that's a 71% increase (inflation adjusted). In stark contrast, the bottom 90% of tax filers in Ontario saw their average income inch up from \$28,700 to \$30,000 for an increase of only \$1,300 — a 5% increase (inflation adjusted) over almost three decades, slightly less than the national average. The richest 1% in Ontario now

receive, on average, 16 times more income than those in the bottom 90%. Thirty years ago, that ratio was only 10 times more.

The even bigger story is the polarization of income in Canada's three largest cities — Vancouver, Montreal, and Toronto — where income inequality is the worst. In Toronto, the city's bottom 90% of tax filers actually receive an average of \$1,900 less (after inflation) than they did 30 years ago, while the top 1% enjoyed substantial income increases. Toronto's richest 1% made an average of \$653,000 each in 2010, up \$356,000 (or two-thirds) from what they made in 1982 (inflation adjusted). The richest 1% now receive, on average, 23 times more than the bottom 90% of the city's taxpayers. That means the richest 1% can earn in about three years what 90% of Toronto's tax filers make in their entire lifetime.

Ontario's lowest income residents — many of whom find themselves in and out of the labour force, often in precarious jobs — predictably felt the brunt of the 2008 economic disruption. The overall poverty rate for Ontarians went from 12.4% in 2008 to 13% in 2009, and then fell back to 12.3% in 2010. (More recent data is not yet available.) For working age adults, the pattern was similar, with poverty rising to 13.3% in 2009 from 12.2% in 2008 and then going down to 12.6% in 2010. So the overall incidence of low income in Ontario, despite a temporary increase in 2009, has not notably worsened. One key reason for this outcome has been the province's limited efforts to address poverty among families with children. With a stated goal of reducing poverty among children and their families by 25% over 5 years, the Ontario Poverty Reduction Strategy initiated in 2008 implemented policies, including the Ontario Child Benefit, that helped child poverty decline modestly from 15.2% in 2008 to 14.2% in 2010.¹³ The reduction in the child poverty rate, in contrast to stability in the overall poverty rate, illustrates how and why smart public policies can make a difference. Clearly, however, much more needs to be done to reduce poverty among all of Ontario's residents.

1.10 Social Assistance Recipients

At the onset of the recession in 2008, the percentage of Ontarians who relied on social assistance hovered around its post-war mean of approximately 5% of the population. Roughly 725,000 men, women, and children were receiving Ontario Works (OW) and Ontario Disability Support Program (ODSP) benefits, out of Ontario's total population of just under 13 million.

By the end of 2008, the economic storm clouds were gathering, and the percentage of population receiving OW and ODSP nudged up to 5.6% of

Ontario's population. Although Ontario social assistance numbers topped out at over 15% of the population in 1932 and almost 14% of population in March 1994, it only peaked at 6.6% of population in August 2012 – almost four years after the collapse of Lehman Brothers in September 2008. With almost 900,000 people receiving social assistance in August 2012, the total post-recession increase in social assistance recipients was exactly one percentage point above, compared to where it was in mid-2008.

How do we explain this surprisingly small increase in social assistance recipients? The “workfare” approach to basic social assistance (minted in the late 1990s by the Harris government of the time) has survived almost intact under successive governments. This has clearly reduced access to the social safety net. As we saw earlier with historically low EI coverage rates, Ontario's income security programs have also failed to protect displaced Ontarians from the painful effects of the recession.

1.11 Household Debt Warning

Stubborn post-recession unemployment and underemployment is especially worrying in light of record-high household debt. Both Bank of Canada Governor Mark Carney and federal Finance Minister Jim Flaherty have repeatedly warned Canadians about the need to control their debt and start saving.

Ontarians owe, on average, \$124,700 in household debt – higher than the national average of \$114,400. Ontario has the third highest average debt per borrower in the country, behind only Alberta and B.C.¹⁴ Much of this debt is related to a housing market that is increasingly considered overvalued in key Canadian cities (including Toronto). High household debt, combined with the potential deflation of the housing bubble, poses a serious risk to Ontario's continuing recovery.

2. Deficit Hysteria¹⁵

2.1 Cause of the Current Deficit

According to Public Accounts of Ontario, the province's fiscal deficit was \$13 billion in 2011–12, “\$3.3 billion ahead of the 2011 Budget Plan and 47 per cent lower than the 2009–10 deficit of \$24.7 billion forecast in the Fall of 2009.”¹⁶ In January 2013, the provincial Finance Minister forecast the deficit for fiscal 2012–13 was expected to come in at \$11.9 billion, once again billions of dollars lower than the official target. And if past experience with

mid-year forecasts is any guide, the final audited numbers for the year will come in even lower.

All signs point to the government's ability to meet its target of reaching a balanced budget by 2017–18, on the strength of continuing (if sluggish) economic recovery. The provincial deficit is a legacy of the 2008–09 recession. The deficit is clearly cyclical in nature (not structural), as evidenced by the prevalence of balanced budgets or small surpluses before the recession hit. The increase in net debt (or accumulated deficit) as a share of GDP since the recession has been moderate, and is clearly manageable — especially given record-low interest rates to service that debt. Putting Ontarians back to work should be the provincial government's central task — and that will facilitate gradual but reliable deficit reduction in the years to come.

This section examines the true extent of Ontario's fiscal deficit. We reject inflated deficit projections that were based on misleading assumptions, and were deliberately intended to stoke an austerity agenda of service cuts and wage freezes.¹⁷ Several years into the sluggish post-recession economic recovery, Ontario appears to be suffering from a case of deficit amnesia: we appear to have forgotten how the province slipped into a fiscal deficit in the first place.

Before the 2008 global economic crisis darkened the province's outlook, Ontario's budget was balanced. Even though there were increases in public program spending in the four years after 2003, they were more than offset by a modest rise in tax revenues, mostly driven by modest, ongoing economic growth.

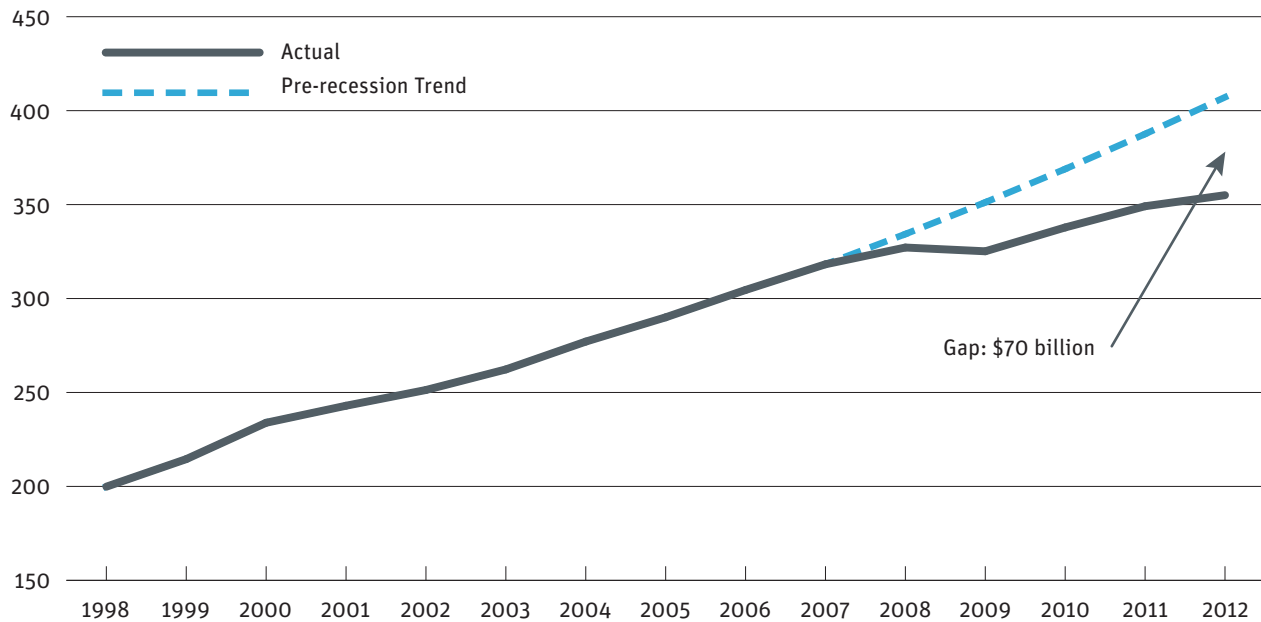
Once the global recession struck, Ontario experienced a rapid decline in employment and GDP, together with a slight decline in provincial revenues as a share of GDP. And there was a predictable increase in program spending as a result of stimulus efforts during the worst of the recession, as well as greater demand for social programs (as normally occurs during a recession).

Figure 5 compares the time trend in provincial nominal GDP over the decade before the recession hit in 2008 to actual GDP recorded since then.

Nominal provincial GDP expanded at an average annual rate of 4.5% during the decade prior to the recession. This was not a spectacular or unusual boom: quite the contrary, the provincial economy was already being undermined by the overvalued Canadian dollar, the erosion of manufacturing jobs, and resulting spin-off effects.

Compared to that modest pre-recession growth path, however, conditions worsened dramatically with the recession. Nominal GDP stagnated in 2008 and 2009. In 2010 it began to grow again with the implementation of stimu-

FIGURE 5 Ontario Nominal GDP



Source Calculations from Ontario Economic Accounts.

lus measures, but then the government hit the brakes and moved toward austerity. The output gap¹⁸ has, in fact, expanded further since the recession ended – because growth, while positive, has still lagged behind the potential trend. All told, as a result of the recession and the subsequent sub-standard recovery, actual provincial GDP is \$70 billion lower than it should be.

Given the normal share of provincial revenues in GDP,¹⁹ this output gap translates into \$12.4 billion in lost annual revenues by 2012. To put that in context, that amount is larger than the expected deficit for fiscal 2012–13.

The relationship between the recession and the deficit can be further highlighted with reference to employment statistics. As noted above, the decline (and non-recovery) in the employment rate corresponds to the absence of 250,000 paid jobs in Ontario’s economy. In other words, if Ontario re-attained its pre-recession employment rate, a quarter-million more Ontarians would be working today.

Those absent jobs impose a painful fiscal penalty on the provincial government. For example, consider the fall below trend of labour income in Ontario:²⁰ as with GDP, labour income fell off its pre-recession trend line and has failed to claw its way back up. The gap between potential and actual labour income – which would have been received by those 250,000

additional workers — totalled \$52 billion in lost labour income during 2012 alone. Imagine if those 250,000 Ontarians were actually employed, earning incomes totalling \$52 billion. This would have resulted in \$5 billion in additional personal income tax revenue,²¹ \$3 billion in additional HST revenue (as those newly employed Ontarians spent their disposable income), and \$1 billion in additional Employer Health Tax revenue.

Those three direct revenue sources alone would have pumped \$9 billion in additional revenue into provincial coffers, almost eliminating the deficit — even before considering any other or indirect revenue effects of stronger employment (such as corporate tax revenues, incomes generated in spin-off jobs, and others). This reinforces the conclusion that the surest way to reduce the deficit is to focus on putting Ontarians back to work. But, as we know, in 2012 the provincial government suddenly embarked on another path — the path of austerity.

2.2 Exaggerated Deficit Claims

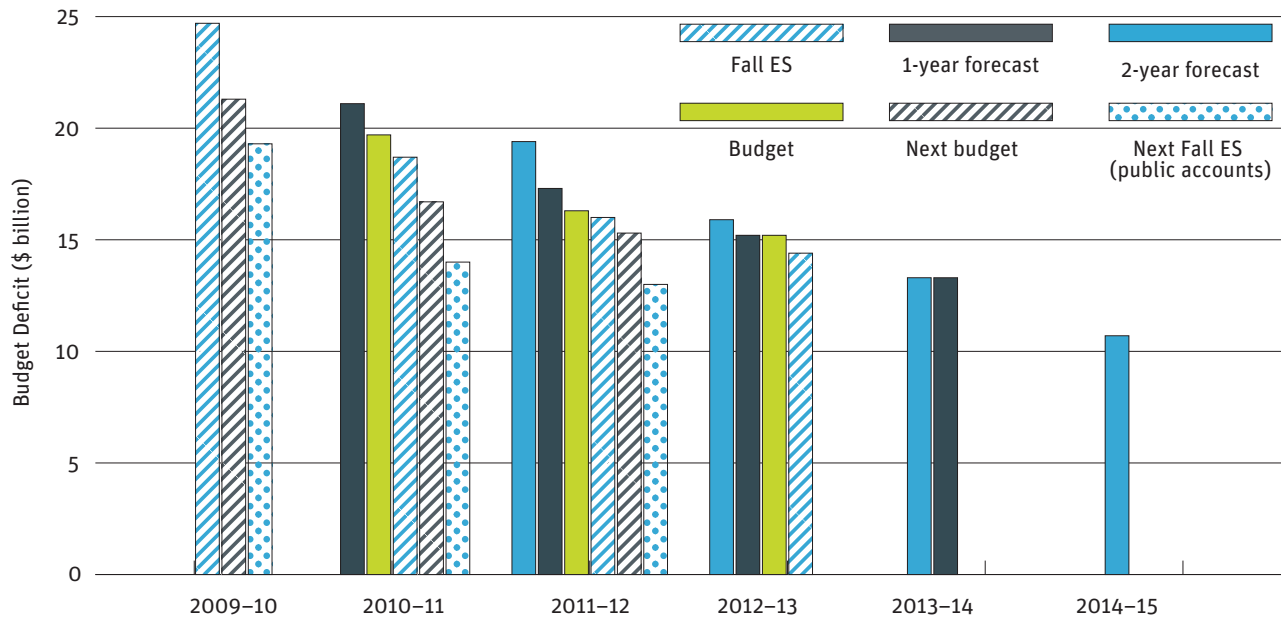
After having reinforced growing deficit hysteria, the Ontario government launched an austerity agenda in 2012. To prepare the public for this painful exercise, and to shift the fiscal goal posts in an austere direction, the government commissioned a far-reaching report from former bank economist Don Drummond, via the Commission on the Reform of Ontario's Public Services.

The exercise was flawed from the beginning, with the government directing the commission not to consider options for increasing revenue but, rather, to focus exclusively on cutting public program spending. It was an imbalanced approach that effectively directed Mr. Drummond to propose austerity. And that is what his report delivered.

The CCPA-Ontario's analysis indicates that the Drummond report relied on overstated deficit projections based on faulty methodology to make the case for a massive list of public spending cuts. Assumptions were based on lower than normal economic and revenue growth, combined with inflated projections of program expenditure growth and government borrowing costs.

These assumptions served to conjure up a fiscal deficit crisis where, in fact, no such crisis existed.²² Already, the distance between Mr. Drummond's inflated projections and reality is growing: Just over a year ago, the Drummond report projected Ontario's deficit would double to over \$30 billion by 2017–18 without implementing recommendations to dramatically reduce government spending. By contrast, the deficit has declined markedly, and is currently expected to equal just \$11.9 billion (barely one-third of Drum-

FIGURE 6 Ontario's Deficit Forecasts: An Evolving Story



Source: Ontario Public Accounts, Ontario Budgets, and Fall Economic Statements.

mond's doomsday forecast) by the latest government estimate. In reality, it could come in lower even than that.

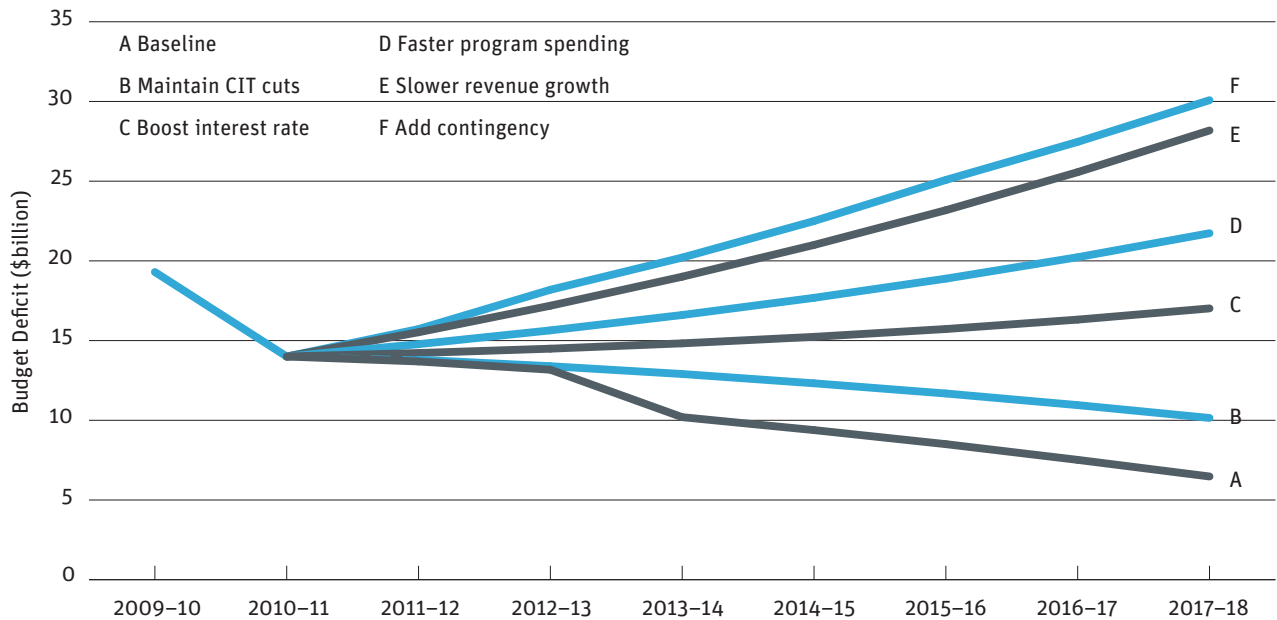
Figure 6 reveals a pattern of overstated deficit forecasts, followed by subsequent “surprise” announcements that the deficit will come in lower than anticipated. This pattern reflects a strategy by the government to jolt the public into accepting draconian (but unnecessary) cutbacks, to be followed by politically convenient euphoria when those phony targets are exceeded.

This strategy of government overstating projected deficits is consistent with ongoing practice at Queen's Park (and by other governments, too, including the federal government). It's misleading and it affects long-term projected forecasts in troublesome ways — especially if phony forecasts are used to justify unwarranted austerity measures.

Figure 7 shows, step by step, how the Drummond report constructed its inflated justification for austerity.

The bottom line on Figure 7 projects Ontario's deficit solely on the basis of expected gradual economic growth (at the same rate as the Drummond report assumed), constant program spending (measured in real per capita terms), and an assumed average interest rate on the government's debt of 3.5% (higher than Queen's Park currently pays). This baseline also assumes

FIGURE 7 Constructing Drummond's Fiscal Crisis



Source Simulations by Hugh Mackenzie based on Commission on the Reform of Ontario's Public Services and Ontario Budget.

that corporate tax reductions are cancelled. Under this forecast, the provincial deficit shrinks steadily as more Ontarians get back to work. By 2017–18 the deficit is down to just \$6.5 billion (and the debt ratio, relative to GDP, has already begun to decline). Now, from that modest starting point, how did the Drummond report deliberately construct a scenario in which without dramatic austerity the province would surely slip into all-out fiscal crisis? Through a series of incremental assumptions, all aimed at worsening the assumed status-quo projection — and all of which were unjustified. The report first assumed that Ontario would indeed fully implement its proposed corporate tax cuts, even in the face of a substantial deficit. That added \$3.7 billion to the deficit.

Next, despite record-low interest rates that have been reducing Ontario's borrowing costs (including on the refinancing, at current rock-bottom rates, of high-interest bonds initially issued in the 1990s), the Drummond report actually assumed that Ontario's average debt interest rate would go up. That assumption added another \$6.9 billion to the deficit projection by 2017–18.

The report then assumed that real, per capital program spending would increase by 0.5% a year (despite promises by all three parties in the 2011

election to reduce real per capita program spending). This added another \$4.7 billion to the projected deficit by 2017–18.

Next, in another departure from proven norms for projecting revenue, the report assumed that Ontario’s revenue would grow at a lower rate than the economy. (In general, barring recession, government revenues typically grow slightly faster than GDP as a result of “bracket creep” and other factors.) That added another \$6.4 billion to the projected deficit in 2017–18.

Finally, the report added another, completely arbitrary “contingency” cushion into the simulation, applied to far-off projections. That added another \$1.9 billion to the deficit in 2017–18 — enough to push the tally above the headline-grabbing total of \$30 billion. So through a series of unwarranted and deliberately pessimistic assumptions and modeling choices, the Drummond report converted a modest, manageable deficit into an impending fiscal trainwreck. In short, the deficit hysteria that has dominated Ontario fiscal debates since the last election is utterly unwarranted. The \$30 billion deficit projection is deeply flawed, built through a series of deliberately misleading assumptions. But if the provincial government was truly intent on speedy reduction of its fiscal deficit, it should have focused first and foremost on economic growth through job creation.

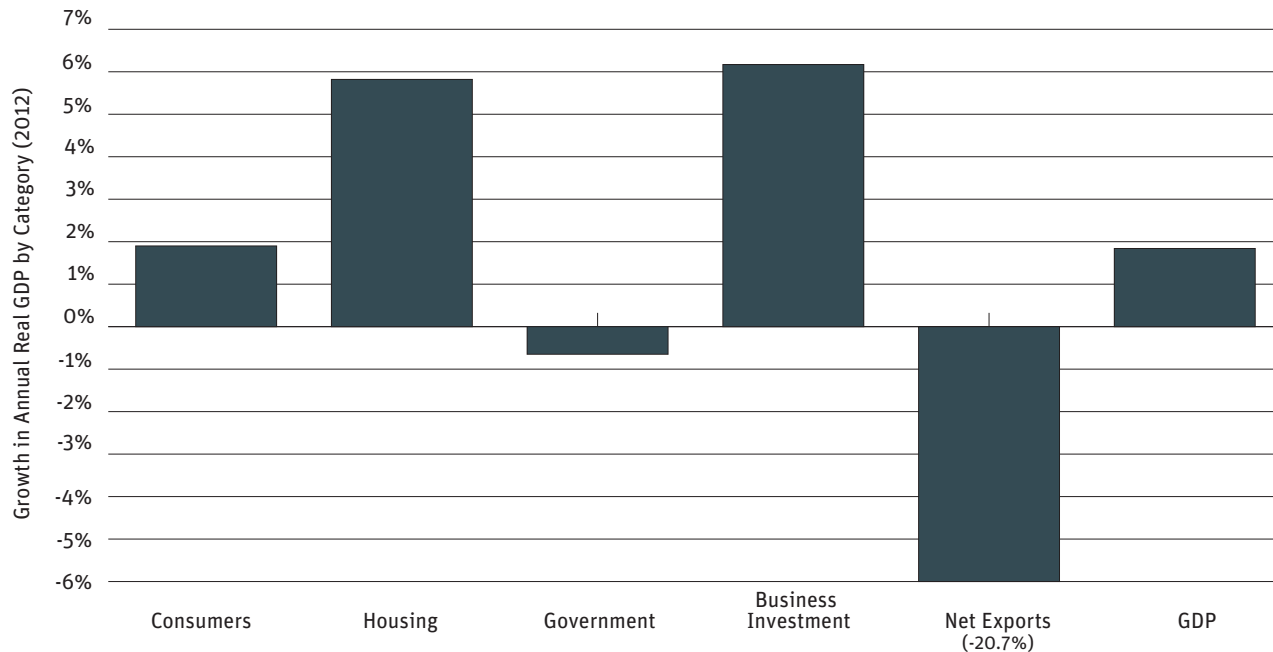
2.3 Fiscal Drag

The provincial government’s sudden and unjustified shift to austerity in 2012 is already contributing to the slowdown in economic growth that was described above. The macroeconomic side effects of spending cuts are termed “fiscal drag” by economists. Less spending on public programs, lower public sector employment, and reduced compensation for public servants all serve to undermine incomes and suppress consumer demand throughout the economy. Among other consequences, this restraint serves to undermine the revenue growth of government itself.

Provincial program spending in Ontario has declined by close to 1% of provincial GDP between 2009 and 2012, at a time when federal and municipal program spending is also constrained — creating a “triple threat” of austerity, if you will.

Economists typically expect a multiplier effect from fiscal restraint of around 1.5, meaning that every dollar reduction in government spending tends to reduce GDP by \$1.50 (once all the indirect and spin-off effects on macroeconomic performance are considered).²³ Considering the direct and indirect effects of fiscal reductions arising from all levels of government (including one per-

FIGURE 8 Fiscal Drag in Canada: GDP Growth by Category, 2012



Source: Statistics Canada, CANSIM Table 380-0084.

centage of GDP or more worth of spending reductions by federal and municipal governments), and applying this multiplier analysis, fiscal drag effects could reduce Ontario's GDP by a total of 3% over the next couple of years.

Unless other economic engines are strongly in gear, generating enough new income and spending to compensate for the cutbacks in public programs, the multiplier effect of fast and deep program spending cuts could easily pull the provincial economy back into recession. The vulnerability of the economy to fiscal drag is illustrated in Figure 8, which shows the year-over-year growth in the various components of real GDP in Canada during 2012.²⁴ Overall economic growth for the year was slow – under 2% (and the economy was slowing further as 2012 came to a close).

The government sector was already shrinking, driven down by spending restraint at all levels. Canadian net exports were also shrinking, barely offset by continuing growth in debt-fueled consumer spending, the housing sector, and business capital spending. The contraction in government spending is accelerating, and the housing sector is now entering a downturn. So it is entirely possible that the overall Canadian economy could shrink in the coming year – dragged down by self-defeating austerity on the part of our governments. Recession, in turn, undermines fiscal progress by damp-

ening revenue growth that is always the crucial driver of deficit reduction. In this sense, austerity can indeed do more harm than good, even from the perspective of its professed goal: deficit reduction.

3. Austerity's Fallout

The global recession and unsteady recovery, followed quickly by austerity measures, has had an impact on more than just jobs and the economy. There is a growing list of collateral social damage flowing from the provincial government's decision to wage austerity in Ontario.

Education: The provincial government's standoff with teachers and school support workers, and the labour unrest that ensued, dominated provincial politics in 2012. It's the most public manifestation of austerity's fallout. The government's decision to impose a two-year contract on teachers and school support workers while revoking their right to strike was justified with the rhetoric of deficit-reduction, but it has contributed to instability within the school system and has unnecessarily opened a hornet's nest of labour rights issues. The Progressive Conservative leader has used it as an opportunity to float as trial balloons American-style laws that would strip Ontario workers of their long-standing and hard-won union rights.

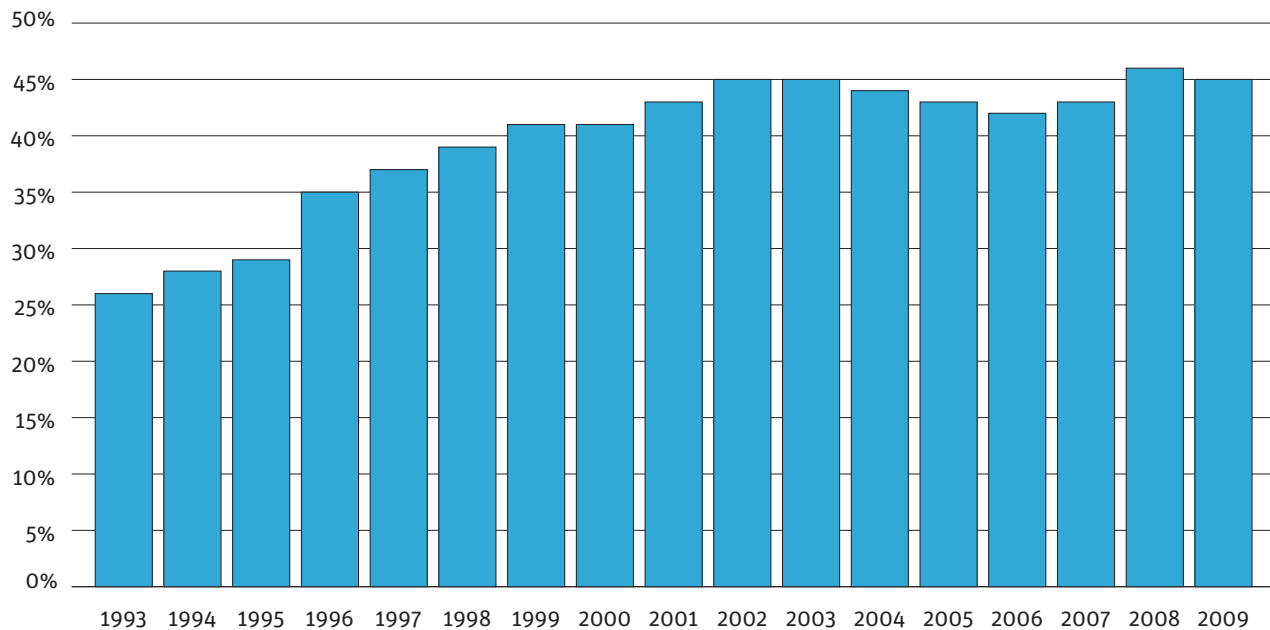
Health care: Ontario's public health care spending is among the lowest per capita in the country, yet the government is planning to implement ongoing cost curtailments. The Ontario Health Coalition, a health care watchdog, reports that global budgets for Ontario hospitals will be frozen at the current level, despite population growth and aging. This implies real cut-backs in service delivery and quality. More than 100 hospital beds are slated for closure. There are planned cuts to hospital operating rooms and some proposed hospital closures. Some physiotherapy, cardiac rehab, pain and audiology clinics are also scheduled to close. Nurses, health professionals and support staff workforce are also being cut, resulting in fewer staff per patient. The coalition is also concerned that fee-for-service hospital funding will require patients to travel further for health care.²⁵

Child care: As a result of a budget agreement between the minority government and the New Democrats, the province's child care sector received emergency funding to help prevent a deeper contraction after years of underfunding and new pressures resulting from the way the province implemented its full-day early learning program. Since then, the province has announced a

change to its funding formula, but the child care watchdog Ontario Coalition For Better Child Care notes it doesn't go far enough: "The biggest problem facing child care funding is still not solved. For the past 15 years, the province has failed to adjust provincial spending on child care for inflation. The health sector gets an inflation adjustment. The educational sector gets an inflation adjustment. But not the child care sector. Every year we are expected to do more with less."²⁶

Post-secondary education: Ontario now has the highest fees for university education in Canada, and those fees are projected to rise to more than \$9,000 a year by 2015–16 — more than 25% above the Canadian average. It is now barely one-third as expensive for median-income families in Newfoundland and Labrador to send their children to university than it is for median-income families in Ontario. By 2015–16, that gap will have increased to four times.²⁷ Meanwhile, students in Ontario are carrying a record-high student debt burden with no relief in sight. Students attending university in Ontario now contribute 44 per cent of total university operating revenues, far higher than the 11 per cent contribution students in Newfoundland and Labrador make toward total operating costs.

FIGURE 9 Tuition and Other Fees (% of Operating Revenue, Ontario Universities)



Source Calculations based on financial reports prepared by the Council of Ontario Universities.

After months of watching Quebec students fight back against rising tuition fees in that province, it should become clear to the Ontario government that it may fast be approaching a limit to its current tuition stance. Ontario has already fallen far behind other provinces in terms of university affordability, and there are signs our own students are getting restless. For a government talking about transforming postsecondary education, its core challenge will be to address the problem it helped create.²⁸

Cuts to the vulnerable: While cuts to teachers' benefits and collective bargaining rights took centre stage in the mainstream media, another victim of the provincial government's austerity measures went a little less public until the 11th hour. In the name of deficit reduction, the province was set to stop funding the Community Start Up and Maintenance Benefit (CSUMB), which provides a vital backstop to low-income families who encounter unexpected housing-related costs (including relocation costs); without this benefit, many of these families would face a significant risk of homelessness (with all its resulting personal, social, and fiscal costs). The cut was slated to come into effect January 1st, but 12 communities across Ontario called the move "inhumane" and mobilized to force the government to reconsider its decision. As a result of that pressure, the government announced a one-time \$42-million infusion²⁹ to Ontario cities to help offset lost provincial funding, but many questions remain about the government's commitment to put a firewall around such vital public services — especially those focused on helping the province's most vulnerable.

4. Recommendations

There is another fiscal problem facing Ontario that was created long before the global recession struck Ontario: the legacy of the Mike Harris tax cuts. The impact of the Harris-era cuts to personal income taxes, corporate income taxes, and other taxes since 1995–96 on Ontario's fiscal capacity has now reached \$17 billion a year. These foregone revenues, still lost to government many years after the Conservatives were removed from office, add up to far more than the size of the current deficit.

Figure 10 illustrates the continuing enormous reduction in Ontario's fiscal capacity that is the legacy of those tax cuts — and the failure of subsequent governments to meaningfully undo them. Harris's personal income tax cuts, which so disproportionately benefited high-income Ontarians, continue to represent the largest loss: some \$10 billion per year (even after ad-

FIGURE 10 Ontario's Damaged Fiscal Capacity



Source Simulations by Hugh Mackenzie based on Ontario Public Accounts.

justing for revenues from the Liberals' new health premium). Billions more were lost to business tax cuts of various kinds, not to mention the interest costs resulting from the increased debt load which the government took on as a result of these tax cuts. It is ironic that the rhetoric of austerity stresses the "unsustainability" of public services and programs — yet never mentions the fiscal damage (including increased indebtedness) arising from tax cuts during a period of deficits. Eventually, both to reduce the current deficit and to fund the expansion of public services into needed new areas, this legacy of short-sighted tax cuts will need to be debated and reversed.

Ontario's economy has become mired in a slow-moving, delicate balancing act between decline and stagnation. There was an interval in 2010 that showed signs of brief improvement, but that recovery was cut short by a premature and ill-advised shift to austerity at all levels. Now the economy

is slowing, in large part because of government spending cuts, and many indicators point to a significant risk of renewed recession – with consequent self-inflicted damage to the government’s own fiscal position.

The provincial government’s 2012 decision to adopt austerity measures – combined with a spate of economic uncertainties, globally and locally – has contributed greatly to the province’s continuing economic weakness.

The provincial government focus on deficit reduction ahead of other priorities – a full jobs recovery, reducing income inequality and poverty, and investing in needed public infrastructure – has the potential to do more harm than good. The growing awareness of the damaging macroeconomic and fiscal consequences of austerity measures taken elsewhere, such as Europe, the U.K. and the U.S., casts doubt upon the wisdom of proceeding with another round of cutbacks here in Ontario.

Global evidence that austerity is the wrong answer keeps stacking up. European austerity is creating a lost decade: another recession in the Euro zone, catastrophe in southern Europe, a triple dip recession in the U.K. Even mainstream economists acknowledge the automatic trigger on austerity measures in the U.S. (pushing that country toward the so-called fiscal cliff) was irrational and counter-productive. The provincial government has all the political cover it needs to now stand down from its austerity perch. Even the International Monetary Fund (IMF) has warned deep cuts can do greater harm than good.³⁰ The World Economic Forum points to income inequality, not government deficits, as the greatest threat to global stability in 2013.³¹

There is no need for a downward shift in provincial program spending. There is no need to reinvent, or privatize, public services. There is no need to curtail fundamental labour rights in the name of deficit reduction. The data in this report point to the self-defeating logic of the current cycle enveloping Ontario: recession causes a deficit; austerity is advanced as the only solution to the deficit; but then, cuts to public spending, wage freezes and job losses create a fiscal drag on an already tenuous economy, potentially pushing the whole fragile system back into recession.

The traditional engines of private sector growth in Ontario are largely stalled. Manufacturing is struggling to rebound. Business capital spending, post-recession, is inadequate, especially relative to still-healthy after-tax cash flows – with the consequence that the business sector as a whole continues to hoard significant amounts of idle cash, despite the economy’s need for spending. Exports have been pummeled by the overvalued Canadian dollar and other challenges. Global economic instability means every jurisdiction is struggling to navigate choppy economic waters in 2013. So much of

Ontario's (and Canada's) economic recovery post-recession has been premised on consumer spending, but with rising household debt and downward pressure on wages, consumers can only spend so much.

Alternative sources of growth require innovative, forward-looking actions. Four ideas emerging from the provincial Jobs and Prosperity Council merit strong consideration: a focused industrial strategy to revitalize manufacturing and other key tradeable sectors; tying business tax reductions to new capital spending to attain more “bang for the buck” from tax incentives; an active procurement strategy to ensure that government itself purchases more made-in-Ontario goods and services; and an ambitious government-business effort to boost Ontario manufactured content in Western resource development projects. Other initiatives which would help to constitute a more comprehensive, progressive jobs and incomes agenda should include:

- Increasing public capital spending, which is not only a job creator but also necessary to rebuild aging infrastructure before disasters strike.
- A minimum wage that doesn't confine Ontarians to working poverty. The province's minimum wage has been frozen at \$10.25 for three years. Nova Scotia indexes its minimum wage every year to reflect the rising cost of living. Ontario should bring it above the poverty line and then adopt an indexing strategy.
- Target employers who violate employment standards, expand proactive enforcement of the Employment Standards Act, and update the Act to ensure protection for all workers, including temp agency workers. Ontario should also ban recruitment fees for temporary migrant workers and act immediately to ensure they're equally protected as other Ontario workers.
- Active sector development strategies to boost investment, innovation, and exports in key sectors,³² including Ontario's struggling manufacturing sector, but other promising industries as well, such as tourism, biotech, business services, and public services. That's certainly how Germany and Korea managed to expand exports and employment (and reduce their own government deficits), despite the challenges of weak global growth.

Conclusion

THE ECONOMIC EVIDENCE suggests the current global emphasis on immediate deficit reduction at all costs has been misguided, ineffective, and is doing more harm than good. Putting deficit reduction ahead of a strategy to secure a complete economic recovery may, in fact, be creating a self-defeating vicious circle: austerity measures aimed at reducing the deficit dampen economic recovery efforts and actually slow down deficit reduction.

To see the process at work, we need only look to the United Kingdom, where austerity has led to not one but three domestic economic recessions following the 2008–09 worldwide meltdown. As a result, any potential fiscal gain from public sector cutbacks have been squandered as a result of self-inflicted macroeconomic stagnation. The same self-defeating result will be attained in Ontario unless the province changes course, and quickly.

The single-minded focus on deficit reduction is also distracting the province from several other serious and pressing economic, social and environmental policy priorities. As an alternative, this report has emphasized the need to get the province's economy humming again, putting Ontarians back to work, and restoring labour and social peace in the province.

Notes

1 <http://www.theglobeandmail.com/news/politics/ontarios-deficit-3-billion-less-than-estimated-duncan-says/article7621426/>

2 Official data will not be available for several months.

3 With thanks to David Macdonald, Laurel Rothman, John Stapleton, and Paul Tulloch for providing numbers and analysis in this section.

4 <http://www.fin.gov.on.ca/en/economy/ecupdates/factsheet.html> and <http://www.fin.gov.on.ca/en/budget/fallstatement/2009/ecotables.html>

5 This decline is far greater than would result from underlying demographic changes.

6 Source: Labour Force Survey, Statistics Canada Cansim Table 282-0070.

7 Source: Survey of Employment and Payroll and Hours (SEPH), Statistics Canada Cansim Table 281-0042.

8 Source: Survey of Employment and Payroll and Hours (SEPH), Statistics Canada Cansim Table 281-0042 and Labour Force Survey, Statistics Canada Cansim Table 282-0010.

9 Source: Labour Force Survey, Statistics Canada, Cansim Table 282-0002.

10 Labour Force Survey, Statistics Canada, Cansim Table 282-0002.

11 Economy At Work, Fall 2012. <http://cupe.ca/economyatwork/economy-fall-2012>.

12 <http://behindthenumbers.ca/2013/01/29/its-time-for-an-equality-premier/>

13 <http://25in5.ca/dec-4-2012-fourth-anniversary-of-poverty-reduction-in-ontario>

14 Statistics Canada. Summer 2012. Perspectives on Labour Income. "Household Debt in Canada". <http://www.google.ca/url?sa=t&rct=j&q=&esrc=s&source=web&cd=5&ved=0CEcQFjAE&url=http%3A%2F%2Fwww.statcan.gc.ca%2Fpub%2F75-001-x%2F2012002%2Farticle%2F11636-eng.pdf&ei=feYSUc3DB-TW2gXVrYGACw&usq=AFQjCNHW4TpjOCbtsag5v8VoyL9ZGNJRg&bvm=bv.42080656,d.b2I>

- 15** With thanks to Hugh Mackenzie for providing numbers and analysis in this section.
- 16** <http://www.fin.gov.on.ca/en/budget/fallstatement/2012/chapter1.html>
- 17** All data and conclusions in this fiscal section are drawn from analysis by CCPA economist Hugh Mackenzie, <http://www.slideshare.net/policyalternatives/beyond-austerity-hugh-mackenzie-16276830>
- 18** Representing the difference between what Ontario is capable of producing and what it is actually producing.
- 19** Provincial taxes and fees of all kind typically collect total revenues equal to 17.5% of provincial GDP.
- 20** Considering wages, salaries, and non-wage benefits.
- 21** Paid at the middle rate.
- 22** <http://www.policyalternatives.ca/newsroom/updates/ontario-budget-watch-post-drummond-pre-budget-analysis>
- 23** The recent IMF review of the macroeconomic consequences of austerity in Europe concluded the fiscal multiplier is in this order (see Growth Forecast Errors and Fiscal Multipliers Olivier Blanchard and Daniel Leigh, IMF Working Paper 13/1, January 2013). Similar estimates are also suggested by the federal government, which estimates fiscal multipliers of up to 1.7 on certain forms of public spending, including income security programs and infrastructure construction (see Canada's Economic Action Plan: A Seventh Report to Canadians, Table A1, January 2011).
- 24** That is the most recent GDP data available; no current data is available on a provincial level.
- 25** <http://www.web.net/ohc/>
- 26** <http://www.childcareontario.org/?p=5983>
- 27** <http://www.policyalternatives.ca/newsroom/news-releases/university-education-canada-becoming-less-affordable-study>
- 28** <http://behindthenumbers.ca/2012/09/11/ontario-tuition-problem/>
- 29** <http://www.cbc.ca/hamilton/news/story/2012/12/27/hamilton-province-funding-csumb.html>
- 30** <http://www.businessinsider.com/imf-admitted-their-economists-were-wrong-2013-1>
- 31** <http://www.weforum.org/issues/global-risks>
- 32** <http://www.workersactioncentre.org/updates/5-priorities-for-kathleen-wynnes-good-jobs-agenda/>



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