

Prosperity depends on urbanization. If Ontario is to close the prosperity gap with U.S. states, it must focus on its cities, looking at four factors

# Ontario's urban gap

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Ontario is the most prosperous region in the world, outside North America. However, when we compare its prosperity to the larger U.S. states, it stands 14th out of 15 and trails their median performance by \$5,905 in gross domestic product per person. That gap is equivalent to \$10,000 in after-tax disposable income for the average Ontario family. Closing it would enhance the economic well-being of Ontarians and generate enough added tax revenue to fund growing health care and education costs — without raising tax rates.

The Institute for Competitiveness & Prosperity, an independent organization funded by the Ontario Ministry of Enterprise, Opportunity and Innovation, has found that one of the recurring themes in this prosperity gap is the importance of urbanization to a region's prosperity. The latest research by leading urban geographers and economists links urbanization, innovation, learning and urban policy, and concludes that cities provide the most stimulating environment for economic progress. In fact, there is a strong relationship between a region's degree of urbanization and its productivity. We found that Ontario's relatively low degree of urbanization is a significant contributor to its productivity and prosperity gap against its peer group of 15 other jurisdictions in North America.

However, further research in the preparation of our latest working paper on urbanization and prosperity indicates that while Ontario's urban areas are more prosperous than its rural areas, they are in fact the source of its prosperity gap versus its peer group. We estimate GDP per capita in the province's urban areas to be 12.8% below that in the peer group's urban areas. By contrast, outside the urban areas, Ontario has a slight prosperity lead over non-urban areas in its peer group. If we are to close the prosperity gap, significant productivity improvements are required in Ontario's cities.

The primary source of the prosperity gap found in Ontario's urban areas is productivity. In fact, the productivity gap of nearly \$7,000 per capita in our cities is larger than the total prosperity gap, overwhelming the advantages in Ontario's demographic profile and utilization of its potential workforce.

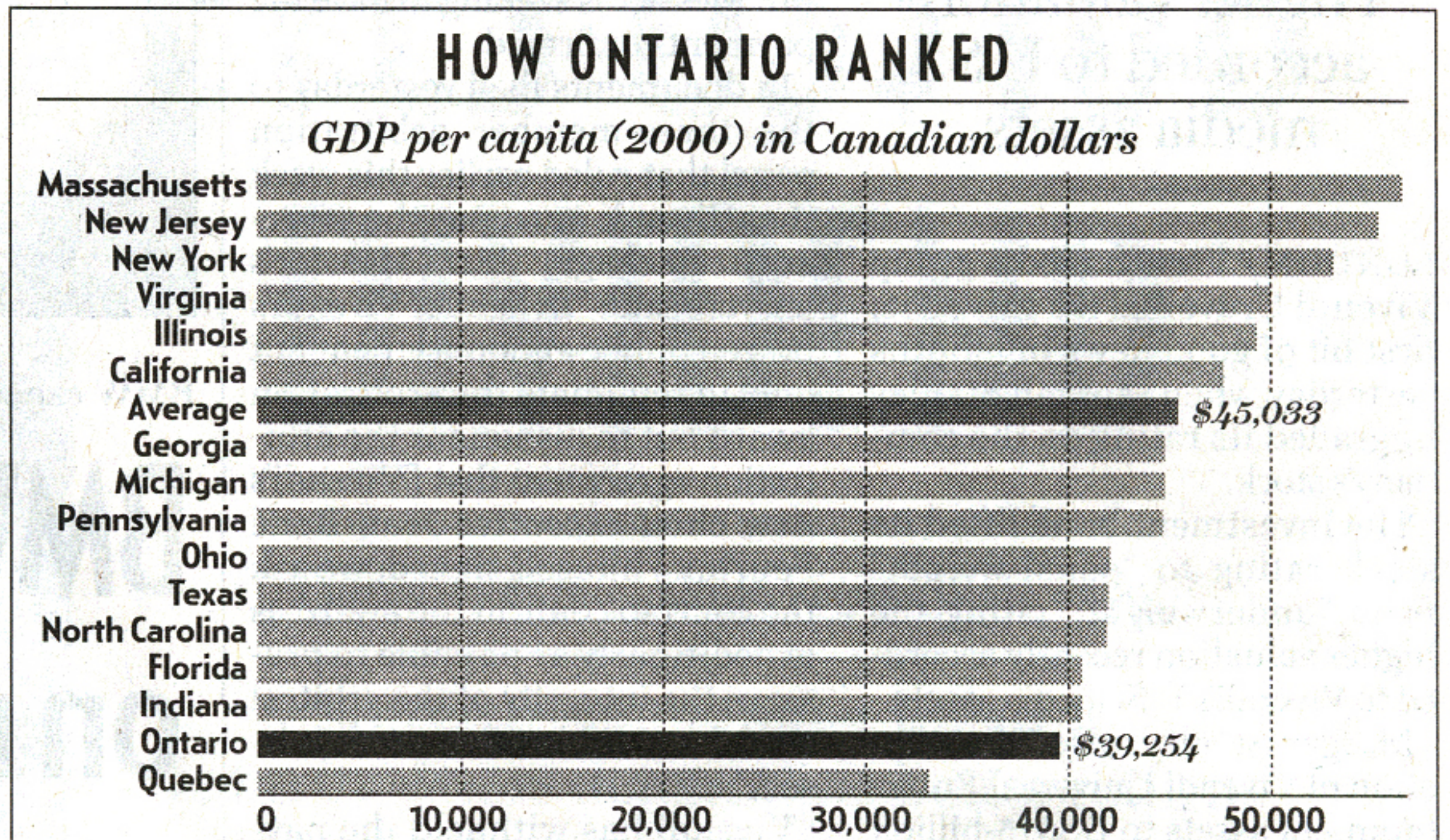
However, Ontario has the capability to strengthen its urban productivity and close the prosperity gap by using its capacity for innovation and upgrading. This capacity is built on an integrated set of four factors: attitudes, investments, motivations and structures.

## ATTITUDES

Success in any field of endeavour is influenced by the loftiness of aspirations, the self-confidence to succeed, the entrepreneurial spirit and the willingness to embrace diversity and creativity. Studies by professors Richard Florida and Meric Gertler identified strengths in Ontario cities in the areas of immigration and creativity.

However, our work identified some aspiration disadvantages related to the education of Ontarians. This is a particular problem for urban productivity because the returns from education are more pronounced in cities than in non-metro areas. For instance, in urban areas, a university degree holder earns 26% more than a college diploma holder.

Ontario students start from an excellent foundation. The province's high school students, at age 15, outperform nearly



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every other group in the world — including U.S. students — on OECD standardized tests in reading, mathematics and science. Among peer group states, only New Jersey outperforms Ontario in the percentage of Grade 9 students who graduate from high school four years later. Yet a smaller percentage of these Grade 9 students enroll in university — 28% of Ontario students versus an average of 30% across the 14 states. Not a vast difference, but in the most prosperous states, such as Massachusetts and New Jersey, the percentages are 48% and 47%.

A more highly educated work force results in higher productivity and prosperity. Many students and their parents believe colleges provide more practical training and better prospects for earnings. But it's not true: A university degree enhances life-long employment prospects and earnings better than a college diploma. Graduate education further enhances these prospects, and we lag the U.S. here as well.

We estimate that Ontario's lower educational attainment — particularly the low-

*The average Ontario family has \$10,000 less after-tax income than its U.S. peer*

er proportion of high school graduates seeking university education and the dramatically lower proportion of university graduates seeking graduate education — accounts for nearly \$1,500 of the \$7,000 urban productivity gap.

We ask with respect to educational attainment: Are we aspiring high enough?

## INVESTMENTS

Aspirations influence, and are influenced by, investments. These include both business investment in capital to enhance the productivity of workers and the public investment in education.

Ontario's businesses invest approximately 20% less, proportionately, on productivity-enhancing machinery and equipment than their peer-state counterparts. Based on work by the Centre for the Study of Living Standards, we estimate that Ontario's considerably lower investment in capital accounts for nearly \$2,000 of the \$7,000 urban productivity gap.

In addition, the lagging investment by Ontarians in education reinforces the impact of their lower educational attainment. An important part of the fabric of our cities is our system of elementary and secondary schools. While recent achievement results are positive for Ontario, its investment in this system is not keeping

pace with the growth in its peer group of states. And worse, Ontario invests at only approximately half the level of its U.S. counterparts in university education.

We ask: Are Ontarians and their business and political leaders underinvesting relative to their U.S. counterparts in the most critical areas for productivity and prosperity?

## MOTIVATIONS

Our review of the impact of taxation on motivation suggests that even with reductions in tax rates at the federal and provincial levels, Ontario's combined marginal tax rate on labour and capital is approximately nine percentage points higher than in a sample of most similar peer-group states. In addition, at the municipal level, its property tax system is causing distortions in investment and location decisions.

For example, the disparity between suburban and city property tax rates is higher in Toronto than in five big U.S. cities we studied. Thus, we encourage development outside the city centre more than U.S. cities do. We also overtax commercial and industrial relative to residential properties, when compared with the U.S. cities we studied. This stifles investment in non-residential building, especially in the city centre. Also, the property tax system in Ontario — and in the United States, for that matter — is overly complicated, and this reduces efficiency.

We ask: Are Ontario's taxation levels and structures dampening the motivation of those in urban areas to work, invest and innovate?

## STRUCTURES

Some of the key fiscal and governance structures supporting cities are not contributing to enhanced productivity. The prosperity of Ontario and its cities is negatively affected by Canada's federal fiscal framework. Ontario's metro voters are under-represented in federal and provincial legislatures. In addition, the municipal governance structure is inadequate to support a significant expansion of fiscal responsibility at that government level.

We ask: Are Ontario's fiscal and governance structures up to the task of closing the prosperity gap?

Ontario needs to take action on all four of these interrelated factors. In particular, we are most concerned about raising the aspirations of our young people as they make decisions to invest in their human capital, and those of our business leaders as they make decisions about how intensively to invest and compete.

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