

# THE ECONOMIC EFFECTS OF LARGE CITIES ON THE CANADIAN ECONOMY

Harvey Schwartz

York University economist Harvey Schwartz asks two important questions: how are Canadian cities governed and what causes them to grow? Concentrating on Canada's three major cities — Montreal, Toronto and Vancouver — he looks at how their growth affects that of the Canadian economy, how the cities are governed, and how they raise their revenue. He also discusses the agglomeration of creative and skilled workers in the three largest cities.

Comment les villes canadiennes sont-elles gouvernées et quels sont leurs vecteurs de croissance ? Pour répondre à ces deux questions clés, l'économiste de l'Université York, Harvey Schwartz, analyse la situation des trois principales villes du pays : Montréal, Toronto et Vancouver. Il examine l'incidence de leur croissance sur celle de l'économie canadienne, leur mode de gestion, la façon dont elles génèrent leurs revenus et les facteurs à l'origine de leur développement. Il s'intéresse aussi à la concentration de travailleurs qualifiés et de créateurs qu'on y trouve.

Canada's cities use various models of government. Neither theory nor practice tells us which model of government is best suited for large metropolitan areas. Models that work well in one jurisdiction may not work well in another one. The government model in one jurisdiction will change over time to reflect population growth, changes in the economy or changes in the political situation.

While voluntary cooperation across municipal boundaries may not be the best model in terms of efficiency or accountability, it is more achievable than a full-scale metropolitan government. The governance structure should cover the entire economic region, but this rarely happens. Over time, economic boundaries evolve and change; political boundaries are more difficult to modify. For this reason some cooperation will be necessary. Consolidations do not necessarily reduce costs. Toronto is a good example of this. Where there is a strong tradition of local autonomy, it will be more difficult to implement metropolitan-wide structures that require the cooperation of local governments. Economics often dictates the ultimate structure. The criteria of economic efficiency and equity are not necessarily considered in designing a new governance structure.

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Metropolitan-wide structuring requires the cooperation of all units of local government. Metropolitan governments need sufficient resources and fiscal autonomy to raise the funds they need to deliver services, but they rarely have them. Few problems stop at municipal boundaries, and a more feasible solution requires larger geographical units and access to a larger pool of resources, both human and financial, than is likely to be available to small local governments.

A strong regional government that encompasses the entire economic region is essential to ensure that services are delivered in a coordinated fashion across municipal boundaries. Interest in metropolitan cities around the world is on the rise, because more and more people are living in these cities. Canada's urban population is expected to reach between 36 and 42 million people by 2031, and a large share of this population will live in large cities. The growth of the urban population has led to air and water pollution, transportation gridlock, deteriorating infrastructure, crime and income polarization. The magnitude and complexity of expenditures are greater in a large metropolitan area than in smaller urban or rural regions, because of the size and the concentration of population in the large metropolis and the presence of a more socially and economically heterogeneous population.

Local governments in large metropolitan areas are expected to provide a sophisticated transportation and communication network and services that improve residents'

quality of life. At the same time, large metropolitan areas attract low-income individuals and households who are seeking work and social services such as social housing, health and income support programs.

There are a number of factors that determine the growth of Canadian cities. These include munic-

**The process of reforming a government is often more important than the outcome itself. All the relevant stakeholders have to be included in the early stages of a restructuring reform for the outcome to be accepted. Metropolitan-wide structuring requires the cooperation of all units of local government.**

ipal tax policy, comparative advantage and the agglomeration of skilled workers. Canadian cities impose a mix of taxes on households and business. The taxes that municipalities impose are important in determining the vocational decisions of households and firms. In the City of Toronto, the business tax is determined by applying a specific tax rate to the assessed value of a business property. The values for residential properties and small businesses are based on the assessed value of the property derived from recent sales in the area. The values for commercial properties and office towers are based on the capitalized values of their rents. The rates for commercial property and office towers were set at 2.5 percent of the taxes paid by businesses in 1997. Toronto's chief financial officer proposed that the city reduce taxes on business and increase taxes on residential property. The proposed shift would be \$150 million phased in over 15 years. The proposal was approved by City Council in 2005. The purpose of the proposal was to encourage business to stay in the city. Tax increases for commercial and industrial property are set at a maximum of one-third of the residential tax increases. The city's goal is to set the commercial, industrial and multi-nonresidential tax rates at 2.5 times the residential rate. This is to be achieved by 2020.

Vancouver is one of the fastest growing cities in Canada. In 2001 the population of the census metropolitan area (CMA) was 1,986,965. By 2006 it was 2,116,581. The growth rate between 2001 and 2006 was 6.5 percent, according to Statistics Canada. The City of Vancouver's population density was the third highest in North America after New York City and San

Francisco. Vancouver's tax problems are similar to Toronto's. The major concern is the shares of the property tax paid by the business and the residential tax sectors. In 2007, the City of Vancouver set up a policy review commission to look into this question. The commission was asked to examine whether the property tax burden on business in the City of Vancouver was too high. The commission reported in September 2007 that while the share of the property taxes paid by business is high relative to the share paid by residential property taxpayers in the neighbouring Greater Vancouver Regional District (GVRD) jurisdictions, there is no evidence to suggest that property taxes have had a negative effect on business investment or the demand for commercial space. Competition for commercial space has kept market rents higher in the city than in the rest of the GVRD. The commission found little evidence of a major problem.

In 2001, the Quebec government announced a plan to merge the major cities with their suburbs. On January 1, 2002, the entire Island of Montreal, with its 1.6 million people, as well as several outlying islands that were also part of the Montreal Urban Community, was merged into a new megacity. Some 27 suburbs and the

former city were merged into several boroughs named after their former cities. In the 2003 provincial election, the Liberal Party promised to submit the mergers to a referendum. As a result of the referendum in June 2004, a number of the former cities voted to demerge from Montreal and regain their former municipal status, but without all of their former powers. The demergers came into effect in 2006.

There are now 16 municipalities on the Island of Montreal (the City of Montreal and 15 independent municipalities). The postdemerger City of Montreal is divided into 16 boroughs and 15 other municipalities. The present City of Montreal has almost as many inhabitants as the former City of Montreal. This is because most of the population lives in the City of Montreal, and the 15 new independent municipalities are mainly low-density suburban municipalities such as Westmount. They also have fewer powers than they did before. Many amalgamated services, such as the Montreal Fire Department, remain with the new City of Montreal.

Despite the demergers, the controversy continues, with politicians focusing on the cost of demerging. Several studies show that the recreated municipalities will incur substantial financial cost, which will cause them to increase taxes. However, those who favour mergers contest these reports and point to reports from other merged municipalities across the country that show that the cost of the merged municipalities exceeds the cost of operating the smaller municipalities. The best example of this is the City of Toronto, as I noted in a February 2010 *Policy Options* article, "Toronto: Trouble in the Megacity."

The population of the Montreal CMA was 1,854,442 in 2001 and 1,812,723 in 2006. The growth over this period was 2.3 percent, much smaller than the growth in Toronto and Vancouver. The primary reason is that

Montreal is much less attractive to immigrants than the other two CMAs, as the 2006 Statistics Canada community profiles attest. The budget for the City of Montreal for 2009 shows that most of its income comes from taxes on residential and business property. The next major category is transfers from the federal and provincial governments. There were a number of other revenue sources, including fees, income from services rendered and quota shares. Unlike the other municipalities, the City of Montreal showed a budget surplus of \$600,057 for 2009. The accumulated surplus, according to Montreal's consolidated financial statements, is \$4,356,421.

Each city has its own explanations of its growth. The growth of many cities in Canada is based on their location near some natural resource, such as forest products, oil and natural gas, and mineral deposits. These cities are usually small, with the exceptions of Calgary and Edmonton. Most large cities in Canada are commercial and administrative centres. Their growth depends on the growth of government and business administration, for example banking and the head offices of industrial and commercial corporations. Large cities are also centres for research and cultural activity, including the major universities, theatre, concerts and the fine arts. They also house significant museums and art galleries. These cities are attractive to tourists, and tourism is an important source of income for many people in these cities.

There are many factors that cause cities to grow. These include a city's economic specialization and its location relative to other cities in Canada. The impact of artistic and cultural activity on the economy has been studied in terms of the economic multiplier effects or the rate of return analysis on the economy.

Artistic and cultural activities play an important role in enhancing the dynamism, resilience and overall competitiveness of a city, the province and

the national economy. They do this by enhancing the innovativeness of workers, firms and other organizations that make up the urban region. With the shift to a knowledge-based economy, cities have become the key to the creation of economic value, by supporting innovation, resilience and quality enhancement. The growth of cities also has the potential to enhance the quality of urban life and the economic opportunities for a broad cross-section of Canadians, as Richard Florida and others have observed.

The first characteristic that is important for the growth of a city is a highly educated workforce. This is one of the most important inputs into the production of goods and services. This workforce is drawn to urban areas that have a critical mass of creative people and activities. A second important characteristic is the presence of dissimilar creativity. This provides the opportunity for learning across disciplines through encounters with other creative people. High-growth cities have a wide range of cultural activities and a social environment characterized by the tolerance of difference and nonconformity and by low barriers to entry into both the social networks and the labour market. For example, Toronto is the centre of the country's financial serv-

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ices industry, with a highly educated and mobile workforce.

Urban economists have noted a change in a worker's primary loyalties from the firm and the industry to the occupational group they are attached to in the urban economy. The design workforce (in such areas as graphic, industrial, interior and theatre design) is growing at four to five times the growth of the overall workforce. This was true for both Canada and Ontario between 1991 and 2001. Artists have raised overall productivity by export-

ing their work to other regions and countries. They also use their creativity to enhance the success of other products and services in other sectors of the local economy by purchasing specialized inputs from local suppliers and enhancing the entrepreneurial cultural life of the region.

The concept of the creative city is derived from the concept of agglomeration. Agglomeration economies are the benefits that firms in the same industry receive when they cluster together. Clustering reduces costs for all firms in an industry and the urban economy because it increases the availability of a pool of skilled workers who can be hired without significant training. Talented people are creative, and their success depends on their ability to assert their creativeness in the workforce. They are drawn to communities of other creative people. This provides a benefit for the firms in the urban economy. The growth of the creative industries increases the pool of skilled labour and the number of firms that supply inputs for the creative industries to locate in the same area.

A critical mass of occupationally similar workers in the same urban area provides the opportunity to learn from other people engaged in the same leading-edge technologies. It also offers the

ability to learn from other workers working in the same area. The presence of dissimilar creative people allows for cross-disciplinary learning through encounters with creative people in other fields and the opportunity to take advantage of the cultural life of the urban area. It also offers a social environment characterized by a tolerance of difference and also low barriers to entry into the social networks and the labour markets. In addition, the growth of the creative industries causes other industries, such as the tourist industry, to grow at an

increased rate. The growth of the creative industries generates external economies for other creative industries and for the urban economy as a whole.

All the measures taken by the federal government to enhance the well-being of Canadians also shape the positive growth of the urban regions. However, there are a number of specific programs that have a direct effect on the creative capacity and the character

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of Canadian cities. The prime example is Canada's innovation policy.

According to a report on innovation and productivity by the Organisation for Economic Co-operation and Development, Canada ranked 6<sup>th</sup> in labour productivity among the 30 countries of the OECD over the period 1998-2008. These include Canada, France, Germany, Italy, Japan, the United States and the United Kingdom. Canada ranked 6<sup>th</sup> in patents per capita and 4<sup>th</sup> in venture capital investments. It ranked second in large firm R&D tax subsidies. Canada also ranked 2<sup>nd</sup> in small and medium firm R&D tax subsidies. It ranked 19<sup>th</sup> in terms of total economic average growth rate among OECD countries between 1995 and 2006.

Another example is cultural policy. It provides direct support for arts organizations. The federal government also provides subsidies and tax incentives to individuals and firms engaged in the production of music, dance, visual arts, film, literature, radio and television, and magazine and book publishing. There is also the legal framework ensuring the freedom of expression and the protection of intellectual property, which helps define the climate that supports and nurtures creativity.

A third set of policies that is important in helping to make cities creative is the immigration and settlement poli-

cies. Newcomers to Canada mostly settle in large cities, where their impact is felt on innovation, literature, film and other media, and in music, cuisine and the distinct ethnic character of many of Canada's large-city neighbourhoods.

Immigration has played an important role in shaping Canada's population. Immigration is responsible for two-thirds of Canada's population growth between 2001 and 2006. Most immigrants settle in large cities.

Immigrants make up 45 percent of the Toronto CMA, 37 percent of the Vancouver CMA and 23 percent of the Montreal CMA. The 2006 census shows that immigrants to Canada were 6.2 million people, or 19.8 percent of Canada's population. In 2006, 94.9 percent of Canada's immigrants, and 97.2 percent of its most recent immigrants, lived in either a CMA or a census agglomeration area. This compares with 77.5 percent of the Canadian-born population.

The provinces share many of the areas of federal responsibility that help support urban growth. City-regions and the provinces must ensure that the urban fabric is qualitatively unique and distinctive and that it is maintained and strengthened.

Ontario cities, with their social diversity and artistic creativity, have the kind of "creativity capital" needed for economic growth and competitiveness in today's world. Many of Canada's city-regions have a large number of researchers, technical personnel, professional artists, writers and performers to fuel economic growth. Public policy in Canada should be geared to promoting this process.

The ability to attract creative people in the arts and culture, and also people of different ethnic, racial and lifestyle groups, provides a distinct advantage to regions in generating innovation,

attracting high-technology industries and promoting economic growth.

The *City of Toronto Act* gives Toronto broad new powers to enable the city to meet its major strategic needs and directions. It also gives the city the right to levy new taxes and to use new financing tools such as tax increment financing (TIF). TIF is a financing method that uses the increase in property tax revenue generated by the redevelopment of an area

to pay for the costs associated with the redevelopment of the property and the area. The concept is new in Canada, and it is being used only by the provinces of Manitoba and Ontario.

It has been used in Pittsburgh since the 1980s with great success. In Ontario, the TIF-based grant is paid to the developer as an annual rebate of part or all of the property taxes generated by the project. The term of the tax rebate is usually about 10 years, and it often includes a sliding scale of annual rebates from 100 percent of the property tax increment in the early years. This decreases to zero at the end of the period. The total of the tax rebates and any other grants and loans provided by the municipality to the developer can not exceed the cost of rehabilitating the property.

Toronto's Official Plan focuses on making the city an attractive and safe place to live. The plan's purpose is to make Toronto a socially and environmentally desirable location and to promote its economic development. The plan links the quality of a place to an integrated economic strategy. These are all connected in a new creative city policy. Toronto's former mayor, David Miller, had a vision of creativity as an engine of economic growth.

Toronto has a wealth of human talent, openness to diversity, a strong social infrastructure, many institutions of higher learning and strong and safe neighbourhoods. It also has strength in its cultural and creative industries. But success requires political will, a commitment to shared action and a sense of urgency.

New tools like TIF are one way to fund critical public infrastructure based on projected revenue from increase in property values. Other tools are urban development banks and intermediary cultural development corporations to support creative enterprises through better networking of people, knowledge and resources.

Toronto's success was built over several years. It is a result of strong plans and policies, as well as determination to succeed. Toronto's Cultural

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Plan is a broad-based 10-year action plan to guide the city's cultural development. It was adopted by Council in 2003. The city has made a major effort to implement the plan.

One example of cities supporting cultural industries was the City of Toronto's decision to rezone older industrial areas and permit the areas to be used by cultural workers as well as by commercial and residential users. The City of Toronto has recently produced a comprehensive plan. Montreal and Vancouver have already done this. The plans emphasize the need to renew the fixed capital associated with the cultural institutions, and they also support the cumulative deficits of many cultural centres in the city.

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Toronto, Montreal and Vancouver are important for generating the growth of the Canadian economy. They are the growth poles of the Canadian economy.

These three cities are the centres of financial and commercial activity, education and research, manufacturing, tourism, innovation and creative activity.

Most of the innovation in Canada comes from these three cities. It is these activities along with other activities that generate growth for the Canadian economy. These three cities also attract most of Canada's immigrants, so they are the areas that generate most of the population growth for Canada. Not only does immigration add to the labour force, it

also generates a demand for goods and services, housing and urban services. These demands are important stimulants that produce growth in the cities and in Canada as a whole. Two sectors, natural and applied sciences, and social science and education, made up 12.6 percent of the 2006 labour force in the Toronto CMA, 13.3 percent of the 2006 labour force in the Montreal CMA and 12.8 percent of the 2006 labour force in the Vancouver CMA.

**T**he population of all urban areas is growing in Canada, but it is growing more rapidly in Canada's three largest cities. With urban growth comes the challenge of delivering services, finding the resources to pay for them and coordinating the services across municipal boundaries as the largest cities expand into the rural hinterland and across other political boundaries. There is an increasing need to coordinate service delivery. The challenges are particular acute in developing countries where population is growing quickly.

How metropolitan areas are governed affects their ability to deliver and pay for services and to coordinate service delivery across municipal boundaries. Fragmentation reduces the

ability of municipalities to solve regional problems on a regional basis and results in uneven fiscal resources. Coordination is especially important for services that cross regional boundaries, such as transportation, planning, and water and sewage. An effective system of governance for the entire metropolitan government is needed to ensure services are delivered efficiently. Very few cities in either the developed or the developing world have such an administrative structure at the metropolitan level.

There is a growing body of evidence that creative activity shapes the competitiveness of a city by enhancing both its innovative climate and the quality of the place, which is important in attracting and retaining skilled workers. Artists make important contributions to regional economies beyond those associated with arts organizations and events, and these contributions are unevenly spread among cities. Public policy is important in nurturing a city's creative assets and infrastructure. The local private and public sectors are the primary forces for creating a creative economy. The policy and regulatory decisions made by the senior levels of government are equally crucial. They provide the core funding and regulatory support for the cultural activities and organizations, and they are especially important in shaping and creating the creative competitive city.

The primary responsibility for determining the physical characteristics of the city rests with the provincial and the local governments. The federal government is included because it is the major owner of urban real estate. The recent attention of the federal government suggests that the federal government's activity may become significant.

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