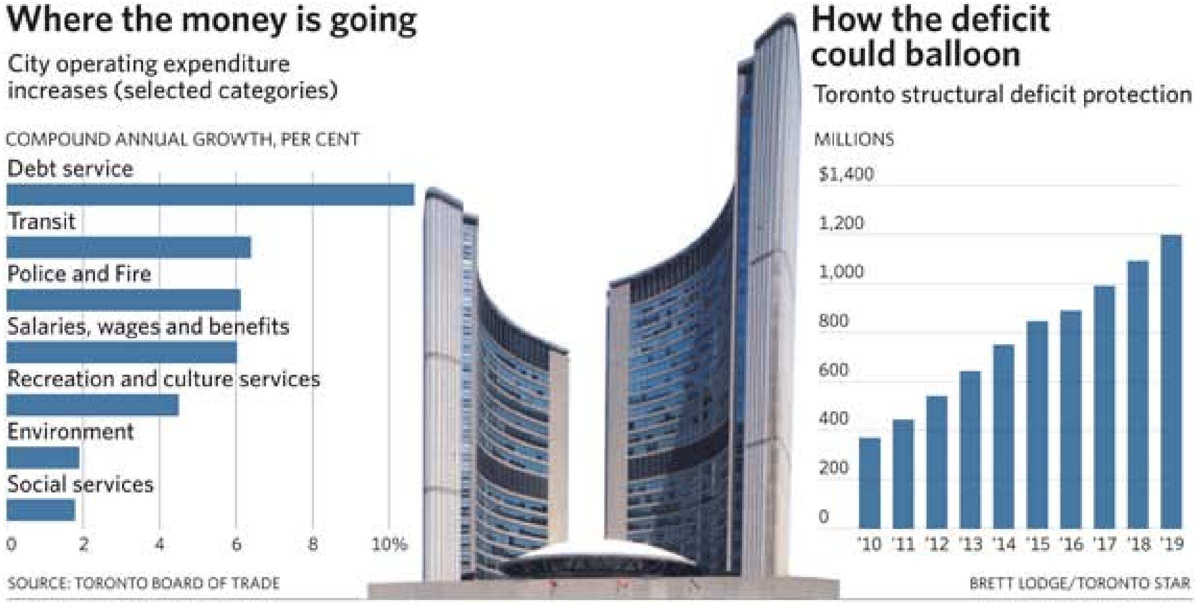

Your day of financial reckoning is nigh, Toronto

Outsourcing, road tolls? If the city doesn't balance its budget, it risks losing business, jobs and basics

DON DRUMMOND AND CAROL WILDING
SPECIAL TO THE STAR

THE BUDGET CRUNCH

FIRST IN A SERIES

With this article, the Star begins examining the city's budgetary crisis and how it should be addressed. In coming weeks, experts, opinion leaders and candidates will be asked to share their views

On Feb. 16 the city of Toronto will unveil its budget for 2010. Already the city, facing a shortfall of some $400 million to make ends meet, has called on all departments to cut their budgets by five per cent — making this the most highly anticipated municipal budget in years.

Yet this $400 million problem is nothing new. And the problem will only get worse unless the mayor and council are willing to "think big" and consider new ideas for restraining spending or raising revenues.

Throughout this past decade, Toronto has depended on a variety of non-sustainable sources of cash, including bailouts from the province and withdrawals from its own reserve accounts, to balance its budget. Put plainly, the city has been running a structural deficit since the start of the decade.

That structural deficit has grown rapidly, from a $72 million gap in 2002 to a $447 million rift last year.

So the $400 million hole for 2010 is hardly a new phenomenon. What has changed, this year, is the likelihood of pulling another rabbit out of the hat to plug it. Toronto has drawn down its reserves to a level much lower than neighbouring jurisdictions.

Meanwhile, the province now has a huge deficit of its own to confront this year. Queen's Park now has 24.7 billion reasons why it is highly unlikely to lend extraordinary help to the city — not just this year, but for the foreseeable future.

This time the city may be on its own to fill the gap. The options are limited: cut spending, monetize assets, or raise more money through a combination of increased property taxes, user fees and new revenue tools.

And because the problem is structural, it will only get worse.

How big could it get? It helps to extrapolate the city's budget out for the decade ahead, drawing upon historical trends and adjusting for known future changes, such as the social services costs that will be transferred from the city to the province. Even if spending growth is trimmed to 5 per cent per annum, but revenues continue to grow at 3 per cent, the $400 million structural deficit for 2010 widens to a $1.2 billion chasm by 2019. Funding a deficit this size would require a 37 per cent property tax hike over current levels. (See chart above.)

But let's not jump to any tax-hike conclusions just yet. We first need to understand how these huge structural deficits emerged, and then consider the full range of options.

THE PROBLEM IS, at its root, a simple one. From 2000 through 2008, the city's operating expenditures increased at an annual average pace of 5.3 per cent. Yet its main source of revenue, property taxes, increased at 3.6 per cent per annum. It is this wedge between the growth rates of spending and revenue that gave rise to the structural deficit.

The city has made some attempts to address the sustainability of its finances, to little overall effect. Increases in user fees have provided some relief: for instance, the 9 per cent annual increases in water rates, in effect through 2012, ensure that water and sewer costs are covered entirely by a fee-for-service arrangement. Toronto's land transfer tax and vehicle-registration fees, introduced in 2008, are adding roughly $200 million per year to city coffers.

Yet despite these measures, the city's structural deficit has continued to grow. Simply put, Toronto's municipal government spends money faster than it collects it.

When you break down the expenditures, you can see which line items have been responsible for the lion's share of the rising costs. Many of the major categories of spending have been increasing faster than the 5.3 per cent average, including roads and transit (6.4 per cent) and police and fire services (6.1 per cent). The city borrows money to build its capital infrastructure, and the interest payments on that debt have been rising at an annual pace of 11 per cent. (See chart above.)

It's quite simple: As spending continues to grow, revenues have not

Wages and salaries have been increasing at a rate of 6 per cent annually since 2000, due to a combination of a growing civic workforce and, most important, annual increases in the cost of wages and benefits.

Clearly Toronto's budget situation is a very serious one. It can be looked at in two ways. The city is either spending money above and beyond what its sustainable revenues warrant, or Torontonians are not paying enough in taxes and fees to sustain the city's spending track. The reality is that both perspectives contain some truth, though it's essential to exhaust all opportunities for efficiencies and cost reductions first.

In its search for solutions, the city will also have to keep an eye on its competitiveness. From 2002 to 2007, job growth in Toronto averaged a meagre 1.1 per cent annually, while the surrounding region added jobs at a yearly rate of 2.8 per cent.

One key contributing factor to this state of affairs is the tax burden on Toronto's businesses, which is high compared to the burden on residents. In 2009, residential properties made up the vast majority (72 per cent) of all real estate value in the city — yet these properties account for only 43 per cent of all property tax revenues. By contrast, commercial and industrial properties account for only 20 per cent of real estate value but provide 40 per cent of all property tax revenues.

To their credit, the city and the province are addressing, over time, Toronto's property tax imbalance. But there remains a significant discrepancy between the commercial tax rates in Toronto compared to competing jurisdictions in the region. Municipal commercial tax rates in Toronto are at least 50 per cent higher than those in Mississauga, Newmarket, Burlington, Oakville and Markham. (Note: raw data is 3.8462361 vs. 2.518507, 2.465179, 2.464680, 2.386773 and 2.299651.)

As the economy emerges from recession, keeping Toronto competitive and boosting employment growth must be a top priority.

TORONTO NEEDS a thorough debate on what should be done about its fiscal problem. And while raising revenues and increased funding from senior levels of government may be part of the long-term solution, this debate will have to focus first on the cost side of the ledger.

Both the Canadian and Ontario governments, mired in deficit, are currently making tough choices about how to rebalance their budgets: which programs will be cut back or eliminated, which will be reformed to new models of operation, and which Crown agencies will be sold or monetized.

They are unlikely to enter into any new funding partnerships with municipalities for the foreseeable future. City hall can no longer avoid making tough choices of its own.

Residents need to be part of the debate. While information on the city's budget can be uncovered, it is not easily understood. It needs to be revealed in a more transparent manner so people can engage in solutions. And it must be cast in a multi-year framework rather than the historical pattern of looking out only one year.

Structural problems can't be effectively addressed with short-term measures. The city needs to examine the budget implications of the decisions it makes now for the next several years.

The examination of the city's cost structure needs to be cast widely. New ways will need to be found to control labour costs. New models of service delivery must be investigated, including introducing competition and doing more outsourcing. For instance, the city currently outsources waste collection in Etobicoke to a private contractor — perhaps that model would be cost-effective if adopted city-wide. The point is that the city likely cannot continue to provide all the services it currently provides without exploring all available alternatives.

On the revenue side, the city will need to consider the monetization, or outright sale, of selected assets. User fees must be closely examined for possibilities of not only raising money but extracting other benefits as well. TTC fees were hiked on Jan. 1, but the total take from the fare box still only covers a portion of the cost of transit. Public transit is heavily subsidized through other forms of taxation, just as is the case everywhere in the world — which is only appropriate. Public transit needs to be less expensive than private automobile travel in order to encourage people to cut back on emissions and lessen traffic congestion, freeing up the movement of goods and services. But governments do not come close to charging people the true, full cost of automobile travel.

Consideration should be given to higher charges for parking. And yes, road tolls should be considered. No doubt measures such as these would be extremely unpopular, but it's just as certain a 37 per cent hike in property taxes would be greeted with little enthusiasm.

Such is the problem with structural deficits. The residents and businesses of this city have become accustomed to receiving a certain level of services, so it is a truly unpleasant surprise to learn that, in fact, the taxes they pay aren't covering their true cost. Delaying the search for solutions only allows the fiscal chasm to grow. The city's problem is a big one, and the search for lasting solutions will require some big thinking.

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