**Association for Canadian Studies in
Australia & New Zealand
1998 Conference
Macquarie University
Sydney, Australia, July 9-11, 1998**

# THE ECONOMICS OF UNSYSTEMATIC PLANNING IN A RAPIDLY GROWING URBAN REGION: THE CASE OF TORONTO

**BY**

**John Robinson & Harvey Schwartz
York University
Toronto, Canada**

## Introduction

Over the last century, both Canada and Australia have experienced urbanization, with an increasing share of the population concentrated in large urban areas. Local governments, which scarcely existed at the time of Canada's Confederation in 1867, were given no place in the constitution. However, since 1867, local governments have become the major providers of people-oriented services. Local governments were initially self-financing, but they have become unable to pay for the increasing range of services called for in modern local governments. As a result, more and more of the financing of local government services was being taken over by the Provincial Governments. Small neighborhoods have always been apprehensive that they would be overwhelmed in the resulting large-scale, homogenized urban areas.[i] The Municipality of Metropolitan Toronto (hereafter Metro Toronto), established in 1954, went a long way towards reconciling the conflict between the efficiency of large-scale organization and consumer-oriented local communities in a federal form of urban government.

This paper discusses the effects of the sweeping changes to this system introduced by the current Government of Ontario elected in 1995. Their policy is to reverse the trend of the last century by shifting the financing of local services back to local governments, enabling provincial income tax rates to be reduced. In Metro Toronto, the mechanism to achieve this result is the amalgamation of the diverse communities into a single city, which is intended to become self-financing. Since the financial resources available to local governments are limited mainly to the property tax, the implementation of the program would redistribute the tax burden, imposing heavy and somewhat arbitrary burdens on Metro Toronto businesses, and create a massive redistribution of income among households, with the heaviest burden falling on middle-income groups.

## 1. The Foundation of Metropolitan Toronto

Before Metro was created there were many problems in the metropolitan area in and around Toronto. These stemmed from the rapid growth of population and industry in Canada over the last 60 years, and from a shift in economic activity within Canada to the southern Ontario region centred on Toronto.

Before the 1950s, the Toronto-centred economy was essentially the City itself, incorporated in 1834. Even as recently as 1951, the City of Toronto was still 60 per cent of the Toronto Census Metropolitan Area (CMA).[ii] After 1951, the City's population stabilized and growth shifted to the surrounding municipalities, which legally were independent jurisdictions but economically were components of the extended Toronto economy (see Table 1).

The administrative requirements of the new urban economy strained the capabilities of the pre-Metro municipal model. On the supply side, City government was responsible for public transportation, water supply and sewage, roads and streets, electricity distribution, education and the regulation of land use. Administratively, these functions were relatively straightforward in the small community. But it became chaotic when many communities were competing for land around the central core. This was true not only for the industrial and commercial users of land, but also for residential users who were concerned about getting to work, their needs for schools, shopping and recreation, and their own individual preferences for congenial neighbourhoods.

The Province's solution was a two-tiered system that could encompass a variety of jurisdictions. The first was the Municipality of Metropolitan Toronto, created in 1954, a federation of Toronto and its suburbs in the southern half of York County.[iii]

Table 1

POPULATION: CITY OF TORONTO AND SUBURBS

| | 1961 | 1971 | 1976 | 1981 | 1986 | 1991 | 1996 |
|---|---|---|---|---|---|---|---|
| East York | C | 104,780 | 106,950 | 101,970 | 101,090 | 102,700 | 107,822 |
| Etobicoke | C | 282,690 | 297,110 | 298,710 | 302,970 | 309,990 | 328,718 |
| North York | C | 504,150 | 558,400 | 559,520 | 556,300 | 562,560 | 589,653 |
| Scarborough | C | 338,020 | 387,150 | 443,350 | 484,680 | 524,600 | 558,960 |
| Toronto | 672,407 | 712,790 | 633,320 | 599,220 | 612,290 | 635,400 | 653,784 |
| York | C | 147,300 | 141,370 | 134,620 | 135,400 | 140,530 | 146,534 |
| Total Metro | C | 2,089,730 | 2,124,300 | 2,137,390 | 2,192,730 | 2,275,780 | 2,385,780 |
| Total GTA | C | 2,922,920 | 3,180,110 | 3,417,720 | 3,733,090 | 4,235,790 | 4,628,883 |
| Total CMA[*] | C | 2,628,043 | 2,803,101 | 3,130,392 | 3,427,168 | 3,893,000 | 4,263,757 |

*Source*: Background Report 1, GTA Demographic Profile, July 1995. In this document, the GTA consists of the counties of Durham, York, Peel, Halton and Metropolitan Toronto.

Table 2

MUNICIPALITY OF METROPOLITAN TORONTO, 1954-1997[**]

Distribution of Responsibilities

| METROPOLITAN TORONTO | CITIES/BOROUGH | SHARED RESPONSIBILITIES |
|---|---|---|
| Metro Police | Fire protection | Parks |
| Metro Transit (TTC) | Electric power distribution | Planning |
| Metro Ambulance | Health services | Roads |
| Wheel-Transit | Marriage licenses | Sewage disposal |
| Social services | Local libraries | Water supply |
| Traffic control | Collection of garbage and recyclables | Solid waste management |
| Major roads | Dog licensing and pound services | Libraries |
| Regional parks | Zoning | Licensing and inspection |
| Welfare assistance | Sidewalks | Economic development |
| Sewer and water service | Street lighting | Snow removal |
| Child care | Harbour | Non-profit housing |
| Reference libraries | Parking lots and permits | Traffic signs |
| Homes for the aged | Traffic regulations | Collection of fines |
| Garbage disposal | Pedestrian crossovers | Storm drainage |
| Processing of recyclables | Local parks | Property management |
| Metro Zoo | Recreation and community centres | |
| Business licensing | Tax collection | |
| Municipal gold courses | Collection of water bills | |
| Expressways and their lighting | | |
| Exhibition Place | | |
| Toronto Islands/ferry service | | |
| Hummingbird Centre | | |

The result was an urban entity that came closer to the economist's concept of an efficient city[iv] than the earlier arrangement. On the cost side, area-wide responsibility was assigned to services where there were economies of

[*]For census purposes, a Census Metropolitan Area (CMA) represents the main labour market of a continuous built-up area having a population of 100,000 or more.

[**]The Municipality of Metropolitan Toronto comprised the Borough of East York and the cities of Etobicoke, North York, Scarborough, Toronto and York.

scale or where there were important spillovers of costs or benefits over local boundaries, such as sewage and water supply, and transportation. At the same time, local services where benefits were more closely focussed on household preferences or called for active citizen participation, such as elementary schools, fire services and local parks, were assigned to the local municipalities. The Tiebout model recognized that different communities had different preferences for local government services. A system of smaller, more homogeneous local governments was more efficient in satisfying those preferences than the large urban area. This was because larger urban governments provided a uniform level of public services to people who did not have uniform preferences for such services. Households could "vote with their feet" by moving to the jurisdiction that provided the package of expenditures and taxes closest to what they desired.

The distribution of responsibilities between the Metro and local governments in Metropolitan Toronto is set out in Table 2. While one might argue over specific items, such as that basic police services should continue to be a local responsibility, or that marriage licences should have been assigned to Metro, this distribution of responsibilities provided a reasonably harmonious balance between the political freedom of complete local control and unrelenting cost-minimizing conformity in metropolitan centralization.

## 2. From Metro Toronto to Mega-City Toronto

In 1995, a new Ontario Government was elected. In December 1996, the Minister of Municipal Affairs and Housing announced legislation to amalgamate Metro and its six member municipalities. "Residents, taxpayers and business will all benefit from one Toronto," he said; "it will reduce duplication and overlap; local government will be streamlined, more accountable, more efficient." [v] The underlying assumption of these forced amalgamations was that "bigger is better,"[vi] and "better" meant lower costs.

This seemed to be *the* justification for the new policy, which would radically transform the system of delivering municipal services. The press release stated that "a single government for all of Metro Toronto would save taxpayers $300 million a year in the long term, . . . once the transition is complete."[vii] These savings would be found "through changes in government structure, service management and delivery [including a reduction of] up to 4,500 employees."[viii]

But no mention was made about the effect on the range and quality of the services being delivered. Nor were the fundamental objectives of the new policy stated clearly.

The normal analytical process would be to identify and evaluate the alternative methods of achieving objectives as defined in specific terms. Statements by the Government are not specific enough to do this. Therefore, we have had to infer the likely objectives of the Provincial Government from appropriate information, including reports commissioned by the government; and also examine amalgamation according to the standard economic criteria for evaluating public policy.

### The Economic Case for Mega-City Toronto

#### *Economies of Scale*

There may be government services where the unit costs of output fall in the long run, particularly where fixed costs make up a large proportion of total costs. The distribution of water is one example (the so-called "natural monopoly" case). If all households wanted this type of service, and if the demand for it were uniform throughout the area, there would be significant *cost* advantages in having a single service supplier.[ix]

However, not all activities of local government enjoy economies of scale. In setting up Metro in 1954, such activities were mostly assigned to the Metro level (See Table 2). If it became evident that some local activity could be handled more effectively at the Metro level, the system would allow the matter to be negotiated between the two levels of government. It would be difficult to imagine a situation so extreme that it could be handled only by amalgamation.

A case could be made that because the Toronto-based economy has extended into the surrounding areas, the Metro functions enjoying economies of scale should follow. This prospect has been proposed in the *Golden Report*.[x] Many such services were in fact extended to the GTA region, and were financed by the Province. These include major highways feeding into central Toronto (Highways 400, 401, 404 and 427) and the *GO Transit* commuter system.[xi] It would be economical to extend other services into this region. Indeed, the Provincial Government has already drafted legislation to bring this about. However, there would be no case for the lower levels of government, the former cities and boroughs of Metro, to be involved.

The above discussion suggests that there might be productivity gains from the consolidation of some services within a metropolitan region like Toronto, but this conclusion receives little support from empirical studies of the costs of local government services. The evidence suggests that consolidation may benefit very small local government units. But beyond a certain size, average unit costs tend to change very little over a wide range of output. When local governments become very large, they tend to produce major diseconomies.[xii]

In a survey of empirical studies, Hirsch stated that the only significant economies of scale were in vertically integrated public services, specifically water, sewage and electricity distribution. In the other urban services, such as police protection, primary and secondary education, refuse collection, fire protection, primary and secondary education, and hospital services, economies of scale were either non-existent, very minor or uncertain (highs schools and hospitals). Furthermore, there is little evidence that horizontally integrated municipal services enjoy scale economies beyond a population size of 100,000 to 200,000,[xiii] a population level reached in Toronto well before the Municipality of Metropolitan Toronto was set up.

*Diseconomies of Scale*

There are many government services which yield no significant economies of scale because of their inherently labour-intensive nature.[xiv] Most of these services were assigned to local governments under the old system. However, there are some municipal services which may yield economies of scale in a technical sense, but where quality deteriorates as scale increases. This is especially true when skilled labour is a significant component, such as in cultural and educational services. Different preferences among communities mean that the demand for many of these services would not be uniform across a metropolitan area. Some local communities may want a municipal symphony orchestra, and others may not; but there is no justification for providing every community with a symphony orchestra, nor for a tax on all communities to pay for them. Acceptance of this principle was a feature of the old Metro system based loosely on the Tiebout model, which recognized that different communities had different preferences for local government services.

*Duplication of Services*

The Minister of Municipal Affairs and Housing, noted earlier, stated that amalgamation "will reduce duplication and overlap: local government will be streamlined, more accountable, more efficient." A cost study, commissioned by the Province, by the KPMG[xv] consulting firm, was used to support these statements. The KPMG study estimated that amalgamation would produce an annual saving of about $300 million by the year 2000. About $100 million would come from replacing seven city governments with one. The remaining $200 million would come from the adoption of unspecified "modern-management techniques." KPMG did not estimate any new capital requirements, but presumed that any extra costs associated with additional capital spending could be absorbed within the normal budget estimates and would not have any effect on the cost saving estimates.

The focus on cost saving is a curious inconsistency because the Conservative Government's emphasis has been on more competition, the very essence of which is "duplication and overlap." In a private sector industry, such as the automobile industry, few economists would advocate improving efficiency by granting a monopoly to General Motors, and eliminating "duplication and overlap" by closing down all the others.

In Andrew Sancton's review of the KPMG study, he points out that many of the services expected to yield savings had already been amalgamated under Metro:

> "Why should practices in the police and ambulance services, transit commission, or sewage treatment and water purification departments change as a result of amalgamation? Given the upheavals everywhere else, they are likely to be islands of calm in a sea of turmoil."[xvi]

In fact, the savings from amalgamation are likely to be extremely limited. The KPMG estimates of potential savings would be about 1.8 per cent of the initial 1998 operating cost estimates for the new City of Toronto, excluding transition costs.

> "Such a reduction is well within the range of what many Canadian municipalities have accomplished as part of ongoing fiscal retrenchment. The numbers produced by KPMG actually demonstrate that amalgamation is not a necessary policy to reduce municipal expenditures within Metropolitan Toronto, excluding transition costs."[xvii]

Transition costs would include changes bound to raise strong opposition from affected interest groups. Attempts to increase the yields of residential and business property taxes have already stirred up strong political opposition in Toronto,[xviii] resulting in some relief in the increase in business taxes. The planners of change have overlooked the role of interest groups with special technical skills. These groups know more about how their systems work than anyone else, and they are in a strong position to emasculate government policies using technical evaluation criteria that politicians and bureaucrats do not fully understand.

The critical role of organized experts was demonstrated in earlier attempts to impose cost-saving policies "from the top down," such as PPBS (Planning-programming-budgeting systems). To be effective, efficiency-improving models require the full cooperation of the parties affected.[xix] Clearly, any proposals to civilianize the police service, contract out road and electrical maintenance, data collection or water treatment would be strongly opposed by the interest groups affected.[xx]

Even less understandable in dealing with a strongly unionized administrative structure such as the City of Toronto, is the assumption that collective agreements can be ignored. As Sancton puts it,

> "Will unions agree to a contract that represents the *average* package of wages, benefits and working conditions among the previous agreements (thereby accepting cuts for a substantial number of their members), or will they successfully hold out for something above the average?"[xxi]

Since the City of Toronto is linked with many labour unions, including some of the most powerful in the country, it should not be assumed that unions would cheerfully accept a policy that involved cuts in wages and other benefits and cuts in employment for their members.[xxii]

*Externalities*

The economic literature on externalities (or spillovers) is enormous, reflecting their importance in economic activity. The basic idea behind an externality is that "the actions of one person or institution may affect the welfare of another in ways that cannot be regulated by private agreements among the affected parties."[xxiii] Externalities may be negative, such as smoke from a factory imposing pollution costs on its neighbors. They may also be positive, such as when taxpayers in one municipality operate a public park used by non-residents.[xxiv]

Externalities are a major reason for government intervention in the economy. However, government intervention is not called for if the problem is trivial, or if it can be dealt with by other means, such as private negotiations or through the courts. Many negative externality problems are dealt with in small municipalities by land-use regulation, such as zoning. Environmental externalities, such as the pollution created in one community that damages the properties or health of residents in neighboring communities, are more difficult to deal with. Other forms of negative externalities arise from traffic congestion or even cultural matters.[xxv]

Where spillovers are significant, one solution is "to set up jurisdictions large enough to contain the spillovers. . . public transportation districts, environmental protection districts, mosquito abatement districts, and so on."[xxvi] In other words, to internalize what previously were external costs (or benefits). Since the minimum size of the jurisdiction required to contain spillovers is likely to vary with each situation,[xxvii] the administrative costs of removing the externality could easily exceed the value of damage it caused.

In Metro Toronto, the likelihood of inter-jurisdictional conflicts was reduced by transferring responsibility for potential conflicts to the Metro level of government, as indicated in Table 2. As the GTA expands, spillovers may extend beyond the boundaries of the new City of Toronto, and this was anticipated in the proposed legislation to create a Greater Toronto Services Board.[xxviii]

## 3. The Costs of Mega-City Toronto

From the economist's point of view, the case for the amalgamation of the cities and borough of Metropolitan Toronto is clearly a weak one. One reason for this is that most of the benefits from cost minimization were already achieved in setting up Metro. Indeed, Metro was too large a unit for some municipal operations, and merging beyond the Metro level led to higher costs. In empirical studies, costs tend to decline as the number of municipalities in a metropolitan area increases.[xxix] This is the competitive argument in the *Golden Report*.

In the sense of maximizing citizens' economic welfare, the Metro organization contained too few local governments rather than too many.[xxx] The existing pattern of local government for the Toronto urban area based on neighbourhoods was developed in the 1960s, and it came closer than Mega-city to the Stigler principle of efficient local government. As Stigler notes:

> "If we give each governmental activity to the smallest governmental unit which can efficiently perform it, there will be a vast resurgence and revitalization of local government. . . An eminent and powerful structure of local government is a basic ingredient of a society which seeks to give to the individual the fullest possible freedom and responsibility."[xxxi]

The attitudes of Toronto voters toward the amalgamation of Metro Toronto were expressed in a referendum held in the last municipal election in Metro Toronto. Despite rejection of the proposal, the Provincial Government implemented amalgamation on January 1, 1998.[xxxii]

## 4. Why Did the Amalgamation Take Place

Given the results of the referendum, it is clear that the Provincial Government forced the new governmental structure on an unwilling community. So, what was the Ontario Government's rationale for the amalgamation of Metropolitan Toronto? Members of the government have said little about their goals for amalgamation beyond some earlier statements that it would result in lower municipal costs. Some light may be shed on the question by looking at how the costs of government in Toronto will be shared between the province and municipality, compared with what it was under the Metro system.[xxxiii]

In early January of 1997, the Provincial Government made a number of announcements about a new division of responsibilities and costs between the provincial and the municipal governments. Those changes are summarized in appendix Table 1. The table is an edited version of another summary table included in a collection of news releases and statements made about the proposed changes.[xxxiv]

A quick review of the table indicates that the Province intended to download a significant share of their costs onto the municipalities. The downloading of costs appears to be based on the view that the new regional cities would achieve significant cost savings. Therefore, they could take on the new responsibilities and costs without any increase in the property tax burden on their residents.

In a recent statement in the provincial legislature, Premier Harris stated that he expected that all classes of property taxes would fall during the next three years despite any redistribution of costs mandated by the Province.[xxxv] Hence, the Provincial Government believed that the new division of costs would help reduce the provincial income tax by shifting some of their existing costs onto the cities. Also, since they believed that there were significant cost savings in amalgamation, the new cities could absorb the extra costs and also reduce their own property tax burdens.

Unfortunately, the facts seem to point in the opposite direction. In order to show this, two issues will be discussed; the new property tax system and the budget for the new City of Toronto.

## 5. Property Tax Assessment

The assessment of property values for tax purposes was a municipal responsibility until 1969, when it was taken over by the Province. The Province set out to reassess all property on the basis of market value. However in 1978, the process was halted, but the Province undertook market value assessment for any municipality that specifically requested it. Some municipalities made a request, but Toronto did not.

In 1997, the Province passed the *Fair Municipal Finance Act*, which would reform the local property tax system based on 1996 values. The new Act also required the updating of these assessments on a regular basis.

Release of the revised property values brought about unprecedented opposition and protests from property owners who faced huge increases in taxes. Many retirees and low income households found that their taxes would more than double, and they feared that they would have to sell their homes in a market that would be glutted by the forced sales of others in the same situation.

One of the basic problems was that houses in Metro Toronto had not been regularly reassessed. The owners of older homes paid taxes based on old valuations. In some cases, the assessments were over 30 years old. As homes changed hands, the relatively low tax bases were capitalized into current market values. The "premium" for low-tax properties escalated in step with the increasing demand for housing in a rapidly growing urban area. But the new 1996 assessments made no allowance for any distortions in the market. When the new values for taxation were announced, the "premium" evaporated, and the arbitrarily-determined 1996 prices of older housing fell **C** but the new taxes were to be based on the new 1996 prices!

That was the problem in principle. In practice the situation was even worse because the values that emerged from the Province's computer programs seemed arbitrary. Identical houses side by side were valued at widely differing figures. Small modest homes on small lots were often assessed at higher values than large elegant homes on large lots. The re-assessment exercise was a rush job, trying to re-structure patterns of relative house values that had developed over decades in a few months. There was no time for any physical inspection of houses **C** the values were based on the most recent sales in the area.[xxxvi] The estimates seem to have been done with computers by students with little training in statistics or asset values.

Having determined the values of Toronto's houses, the next step was to establish the tax rate, which had to be "revenue neutral." The initial rate selected was 1.23 per cent, which would yield the same revenue as before amalgamation, but with a greatly altered distribution of the tax burden. The averaging process produced large zones of taxpayers who would pay substantially higher taxes, and other zones in which taxes would be much lower. There did not seem to be much relationship between tax liability and taxpayer income.[xxxvii] Subsequently the City Council realized that 1.23 per cent would not be enough, so rather than exacerbate angry taxpayers further, the Council borrowed $100 million from the Provincial Government. However, even at this late stage (June, 1998), the Council does not know what the 1998 tax rate will be.

6. Property Tax Assessment on Business

The municipal business tax is applied to most commercial and industrial properties in Canada. Unlike residential property taxes, business taxes are levied on the occupier rather than the owner of real property. In Ontario the assessed value for business tax purposes is determined by applying specific percentages to the assessed value of business property.

On March 3, 1998, financial officials of the City of Toronto released the new assessments on business and commercial properties, which showed substantial increases with the heaviest relative increases on small businesses. Nearly half of commercial business in Toronto found their taxes would increase by 100 per cent or more. Not surprisingly, the protests were loud, strong and persistent.

As noted earlier, residential taxpayers will no longer pay property tax to finance education, but businesses will. Businesses in Toronto, however, will pay taxes at twice the rate paid by most other municipalities in the Province, including the areas immediately surrounding the City (the Greater Toronto Area), providing a further incentive for businesses to move to the suburbs.

There were anomalies in the valuation system: the "market values" of residential properties and small retailers were inferred from recent sales in the area. The values of major commercial properties and office towers were based on the capitalized values of rents. The result was that the assessed values of small businesses went up, some by 1000 per cent, and the assessments of bank towers went down![xxxviii]

Apartment buildings were subject to a different set of rules. In Metro, the property tax on apartment buildings was about three to four times the rate on single-family houses and condominiums. In the new Toronto the discrimination continues, justified on the curious ground that owners of rental buildings would not pass on tax cuts to tenants.[xxxix]

Faced with the business community's tax protests, the Toronto and Ontario Governments agreed to limit property tax increases for business to 2.5 per cent a year. This was not 2.5 per cent of the current value assessments introduced in 1998, but 2.5 per cent of the taxes businesses were paying in 1997. If the

City required more money, it would have to increase residential taxes.

To accommodate the changes, the Provincial Government introduced Bill 16 in May, 1998. The new bill gives cities and towns the option of putting an annual 2.5% cap on business tax increases. The bill is expected to get third reading in the middle of June, 1998.[xl]

Table 3
Budget Estimates for Community Services
City of Toronto, 1997 and 1998
(000,000's of dollars)

| | 1997 Budget | 1998 Budget | Change |
|---|---|---|---|
| Operating Expenditures | 1,781,823 | 2,408,921 | 627,098 |
| Revenues | 1,386,729 | 1,598,958 | 212,229 |
| Net | B395,094 | B809,963 | B414,869 |

Source: Toronto Star, May 25, 1998.

Table 4
Budget Estimates for the
Toronto Transit Commission, 1997 and 1998
(000's of dollars)

| | 1997 Budget | 1998 Budget | Change |
|---|---|---|---|
| Total Revenue | $529,189 | $564,778 | $35,589 |
| Operating Expenses | 691,577 | 716,346 | 24,369 |
| Net Difference | B162,388 | B151,568 | +10,820 |
| Subsidies | | | |
| Metro Toronto | 81,865 | C | |
| Province of Ontario | 77,523 | C | |
| Total Subsidy | 159,388 | C | C |
| Balance from Taxes | B3,000 | B151,568 | 10,820 |

Source: Toronto Star, May 18, 1998.

7. The City of Toronto Budget

The problems associated with property tax assessment and the late passage of Bill 16, has had a significant cost impact on the new City of Toronto. On June 5, 1997, the City's chief financial officer stated that because of the late delivery of the property assessment rolls from the Province, the property tax bills, normally issued in May, would be delayed until August.[xli] While the new City has set most of its budget for 1998, it hasn't yet decided how to set the tax burden among the different classes of taxpayers. This is not likely to happen until some time in July or even later. As a result, the City may have to borrow to finance its spending until the income from the new property tax is received.

8. The 1998 City Budget

The 1998 budget is still being revised as the City Council seeks new ways of reducing its costs. However, the general aim of the budget is to freeze overall 1998 property *tax receipts* at their 1997 level so that there will be no overall increase in *City taxes*. Because of the new Provincial Assessment Program and the proposal to eliminate or reduce the rate of increase in business taxes, the distribution of the property tax burden is likely to be very different than it was in 1997. The 1998 budget is an attempt by the new City to slow down the adjustment process by budgeting for an overall zero net tax change and by trying to maintain service levels close to their 1997 levels.

The 1999 budget is expected to have significant cost reductions and likely significant reductions in services if the tax burden is to be maintained. The problem the City faces is how to cope with the downloading of Provincial costs on the new City.

Two examples will be cited to show the problem that the new City faces. Table 3 shows the community services budget, which includes spending on social welfare, public health and public housing among others. This budget is projected to include an increase of $627 million in spending compared to the 1997 budget. Most of this increase is related to the downloading of Provincial costs on the City. After user fees and other revenue are included, the budget produces a net deficit of $415 million which will have to be financed by property and business taxes.

The operating budget of the Toronto Transit Commission, in Table 4, shows a similar pattern. In 1997, it had an operating cost deficit of $159 million which was financed by subsidies from Metro and the Province. In 1998, the TTC expects a deficit of $152 million and this will also have to come out of City tax revenue because of the loss of Provincial grants.

Conclusion

What is the verdict on Mega Toronto after the first six months? The first casualty has been the cost savings for municipalities, which were the driving force for the great reforms. Since these cost savings would be so great, the municipalities could finance their own expenditures. The Province could then cut grants to the municipalities, and the savings would make it possible to cut income taxes by 30%, as promised in the election campaign.[xlii]

What has become evident, however, is that costs will not fall in the amalgamated City. Costs will rise even to maintain services at the 1997 levels. The evidence indicates that any cost savings will be minor.

How would the City pay for its expenditures, given that the mainstay of municipal revenues is the property tax?[xliii] Again, the answer seemed simple. Update the tax base, change the values of all properties to current market values, and sweep aside decades of capitalization, rent control and other market adjustments to the demand and supply of land and housing. Such methods of estimating values may make some sense in a daily market for the flow of commodities, but the prices set in the property market are for marginal changes in the housing stock. In a city of three million, current housing sales represent a minute fraction of the housing stock, and are hardly the basis for re-calculating the values of the entire housing stock.

The results of the new assessment system have been chaotic. The new assessments on business were so clearly inequitable and incompatible with business efficiency that the Provincial Government had to accept an expedient but rigid policy that sets severe limits on future tax increases. The residential assessments were arbitrary and inequitable among individuals, and inequitable among the former municipalities, as the map shows. Far from being "revenue neutral," the new City's revenues were not sufficient to finance new Toronto's expenditures, and $100 million had to be borrowed from the Province. At this late stage (end of June), the City Council does not know what the 1998 tax rate will be, but warnings are being issued that it will be considerably higher than the 1.23 per cent that set off the wave of protests in March and April.

One of the basic misjudgments in the Toronto experience has been the Provincial Government's assumption that the Toronto economy, the GTA and the Provincial economy were separate entities. They are in fact an integrated economy. The central City provides accounting, banking and legal services for firms, as well as cultural and education amenities, for the urban region and the Province. The outer urban region provides not only housing but also manufacturing, retail trade, wholesaling and other business services for the whole region. The relevant model is not the self-sufficient country town but the provincial economy, and all sectors that provide basic services for the whole.

The correct role for the Province is one of co-ordination. It is not the proper role of residents of Toronto to finance the services enjoyed by the whole region and the Province. The growing use of intergovernmental grants is a recognition of these interdependencies in modern economies. The attempt of the Provincial Government to shift a large share of the financing of the region to the businesses and residents in the central core will result, not only in excessive administrative and compliance costs (which are already evident), but also in increased outflows in employment and industry to the detriment of the region's development. The attempt to finance local government by massive increases in an inequitable and distortionary tax, such as the local property tax, is likely to reduce development even more.[xliv]

Many of the problems faced by the new City of Toronto arose from a determination of the Provincial Government not only to force amalgamation, but also to introduce a large number of other changes, and especially, the new property tax assessment system and the downloading of costs. These changes were introduced without any clear plan of how to handle the consequences of all of these changes occurring at the same time.

Therefore, the economics of unsystemic planning of the changes has led to significant extra costs, confusion about how to proceed, and a major future confrontation between the City and the Province, and the City and its employees and taxpayers. As one cynical observer has pointed out, the Provincial Government has a tendency to try to fix things that are not broken.

Map 1

Map 2

## ENDNOTES

i.. See the extensive literature on new towns, from Ebenezer Howard's *Garden Cities of Tomorrow* (published 1898) to the present. A. J. Robinson, *Economics of New Towns* (New York: Praeger, 1975), Ch. 1.

ii.. For census purposes, a Census Metropolitan Area (CMA) represents the main labour market of a continuous built-up area having a population of 100,000 or more. In the 1951 census, the Toronto CMA had a population of 1,117,470. The City of Toronto's population was 675,754 or 60% of the total CMA's population.

iii.. Originally there was one city, four towns, three villages and five townships, but in 1967 the original municipalities were regrouped to form the six municipalities that existed until December 31, 1967: the cities of Toronto, North York, Scarborough, Etobicoke, York and the Borough of East York.

iv.. The basic article is Charles M. Tiebout, "Pure Theory of Local Expenditures," *Journal of Political Economy*, October 1956, 416-424. For a more detailed discussion of the Tiebout model, see George R. Zodrow, ed., *Local Provision of Public Services: The Tiebout Model after Twenty-Five Years* (New York: Academic Press, 1983).

v.. "Unified Toronto to save money, create jobs," News Release, Ontario Ministry of Municipal Affairs and Housing, Toronto, December 17, 1996.

vi.. "Study Shows One Toronto Would Save Taxpayers $300 Million A Year," News Release, Ontario Ministry of Municipal Affairs and Housing, Toronto, December 16, 1996.

vii.. *Ibid*. These cost estimates do not take into account the transition and other costs of moving to the new system, estimated at $150-220 million between 1998 and 2000. The projected saving of $300 million may be compared with the initially announced 1998 operating budget for the City of Toronto of $5,600 million, and the capital budget, of $1,100 million. City of Toronto, "1998 City Budget Process," April 30, 1998.

viii.. *Ibid*.

ix.. The emphasis here is on *costs*. If consumers preferred some other alternative and were willing to pay for it in user charges or additional taxes, the alternative would be the appropriate choice.

x.. *Ontario Task Force on the Future of the Greater Toronto Area: Report of the GTA Task Force*, Queen's Printer for Ontario, Toronto, 1996.

xi.. GO Transit (GO stands for Government of Ontario) is a provincially funded interregional passenger transportation system of bus and train service, which transports 130,000 passengers daily, mostly from the GTA area to downtown Toronto.

xii.. Werner Hirsch, *Urban Economics* (New York: Macmillan, 1984), 270.

xiii.. *Ibid*., 273.

xiv.. W. J. Baumol, "Macroeconomics of Unbalanced Growth: The Anatomy of Urban Crisis," *American Economic Review*, June 1967, 415-426.

xv.. Klynveld-Peat-Marwick-Goerdeler (KPMG), "Fresh Start: An Estimate of Potential Savings and Costs from the Creation of a Single Tier Local Government for Toronto," December 16, 1996.

xvi.. Andrew Sancton, *Toronto's Response to the KPMG Report, Fresh State: An Estimate of Potential Savings and Costs from the Creation of a Single-Tier Local Government for Toronto* (Toronto: Board of Management, December 17, 1996), 3-4.

xvii.. *Ibid*, 5.

xviii.. See later section.

xix.. See A. J. Robinson, *Economic Evaluation of Municipal Expenditures: PPB* (Toronto: Canadian Tax Foundation, 1971), and Douglas G. Hartle, *The Revenue Budget Process of the Government of Canada: Description, Appraisal and Proposals* (Toronto: Canadian Tax Foundation, 1982).

xx.. Sancton, *op. cit*., 5.

xxi.. *Ibid*, 6.

xxii.. In the near future, four major unions will be bargaining with the City of Toronto: the Amalgamated Transit Union, the Canadian Union of Public Employees (electricity workers, inside workers of old Toronto, outside workers and some library workers), the Ontario Provincial Fire Fighters Association and Toronto Police Association. Toronto: Ontario Federation of Labour, June 1998.

xxiii.. E. S. Mills and B. W. Hamilton, *Urban Economics* (Glenview: Scott Foresman, 1989), 158.

xxiv.. We exclude from the discussion *pecuniary externalities*, which show up as changes in prices and profits but do not change the technical possibilities of production or consumption. See C. V. Brown and P. M. Jackson, *Public Sector Economics* (Oxford: Martin Robertson, 1978), 30.

xxv.. A common situation is where the benefits of downtown theatres, museums, and sporting facilities serviced by Toronto taxpayers spill over to suburban residents, who enjoy the facilities but pay only part of their cost.

xxvi.. John F. McDonald, *Fundamentals of Urban Economics* (Upper Saddle River: Prentice-Hall, 1997), 267.

xxvii.. George F. Break, *Intergovernmental Fiscal Relations in the United States* (Washington: Brookings, 1967), 174-180.

xxviii.. "Greater Toronto Services Board would improve services, reduce costs," Ministry of Municipal Affairs and Housing, March 12, 1998.

xxix.. David A. Sjoquist, "The Effect of the Number of Local Governments on Central City Expenditures," *National Tax Journal*, May 1982.

xxx.. Efficiency in this sense requires "a system of governance in which governments are small enough to give local residents a choice, the political process allows local voters to reveal their preferences, and the local government has the fiscal autonomy and technical capability to reflect voter preferences in its budget and service delivery" (R. W. Bahl and J.F. Lim, *Urban Public Finance in Developing Countries* (Washington: OUP for the World Bank, 1992), 412-413. These conditions were certainly satisfied in Metro Toronto.

xxxi.. George J. Stigler, *op. cit*.

xxxii.. The legal basis for the amalgamation was the passage of Bill 103, which received royal assent on April 21, 1997. This Bill sat out the political structure of the new City of Toronto and authorized the transfer of the assets, the liabilities and the by-laws of the previous seven municipalities to the New City of Toronto. The Act also created two transitional boards to supervise the transition from the old structure to the new one. The two transitional boards, the Financial Advisory Board and the Transition Team, were dissolved on January 31, 1998.

xxxiii.. *Backgrounder: Who Does What? Where Will the Changes Be?* Toronto: Ministry of Municipal Affairs and Housing (December 1996).

xxxiv.. *Ibid*.

xxxv.. *Toronto Star*, June 4, 1998.

xxxvi.. There has been no rigorous study of the relationship between taxpayer income and tax liability in the new Toronto. However, a map of increases and decreases shows a narrow band of tax *increases* of 20-30 per cent, and of *decreases* averaging about 10 per cent. This is not the distribution of income. See *The Toronto Star*, March 4, 1998.

xxxvii.. Karin Treff and Ted Cook, *Finances of the Nation* (Toronto: Canadian Tax Foundation, 1995), 6:13B6:14.

xxxviii.. One comment: "The key to this policy is that tenants do not vote, so let's keep the money." Terence Corcoran, "Harris Should Kill Property Tax Plan," *The Globe and Mail*, March 14, 1998.

xxxix.. *Ibid*.

xl.. *Toronto Star*, June 4, 1998.

xli.. *Toronto Star*, June 5 1998.

xlii.. Since Provincial income taxes are calculated as a percentage of the federal rate, the real value of any Provincial tax change will be affected by the federal tax rates. In fact, the Premier has complained that most Ontario taxpayers failed to notice his much-vaunted tax cuts because of offsetting adjustments in federal tax rates.

xliii.. Alternative sources of revenue, such as the sales tax and the income tax, which are used in other large cities and in fact were used in Toronto before World War II, would require consent of the Provincial Government. There is no indication that such consent would be given.

xliv.. Recent studies have shown that variations in local taxes can have sizable impacts on local business in the region. J. F. McDonald, *Fundamentals of Urban Economics* (Upper Saddle River: Prentice-Hall, 1997), 439.