TD Bank Financial Group

# TD Economics

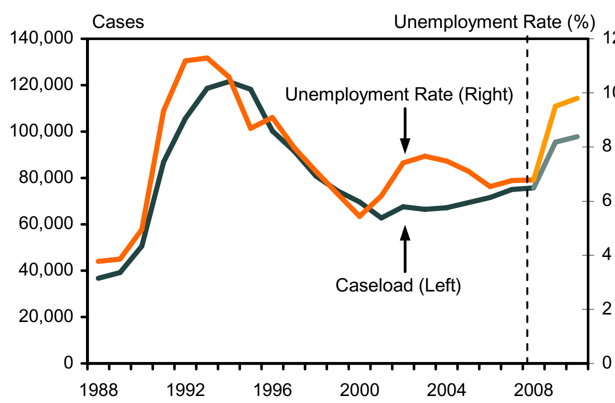
## Special Report

February 9, 2009

# TORONTO FACES LARGE FUNDING BURDEN FOR SOCIAL ASSISTANCE

The City of Toronto's draft budget will be released for discussion on February 10th. Although allowed to borrow for capital outlays, the City is prohibited by law from running an operating deficit. Therefore, as usual, there will be considerable interest in whether the City can generate a budget where operating revenues equal operating expenditures, and what – if any – tax increase will be required to achieve that objective. In addition to the usual spending pressures – many of them structural in nature – the City will face the added challenge of sharply-rising social assistance costs over the near term. We estimate that this element alone could add $65 to $70 million to the City's spending in the upcoming year. This is equivalent to a 4% to 5% increase in residential property tax revenues. As well, if the province increases the accessibility of social assistance and does not adapt the structure for cost-sharing, the City's costs would spike higher.

**SOCIAL ASSISTANCE CASELOAD FOR TORONTO**




Sources: City of Toronto, Statistics Canada, TD Economics

### HIGHLIGHTS

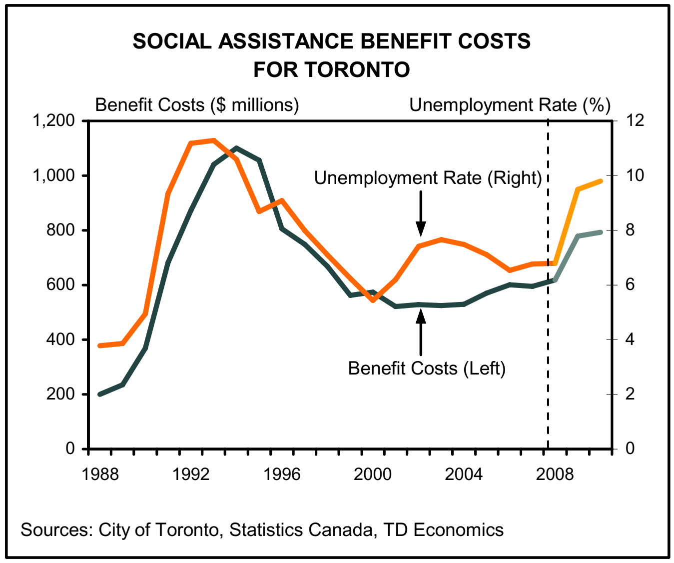
- **The City of Toronto faces a significant social assistance burden: while constituting 20% of Ontario's population, the City administers 38% of the Ontario Works caseload. Over 5% of the City's population was on social assistance in any month of 2008 compared with 2.5% province-wide.**
- **We estimate that Toronto's average monthly social assistance caseload will surge by 18,000 to 20,000 over the 2009 recession, imposing $65 to $70 million in additional costs on the City. If borne by property taxes, Toronto would at least need an additional 4% in revenues from the residential base.**
- **While the McGuinty government has commendably committed to fully upload benefit costs by 2018, municipalities will continue to bear 20% of benefit costs during 2009 and 19.4% in 2010. As well, if the provincial share of administrative costs remains capped, Toronto will bear 100% of increases in these costs.**

### Social Assistance Funding in Ontario

Social assistance provides needed benefits to vulnerable, low-income households. In Ontario, the program is entitled Ontario Works (OW) and an earlier term is "welfare". Ontario is unique among all provinces in imposing a portion of the benefit costs for social assistance on municipalities. Under the OW program, municipalities' departments of social and community services administer the benefits, and the province reimburses the municipality. The province funds 80% of benefit costs and the municipality is responsible for the remaining 20%. The financing burden for the City of Toronto is particularly onerous: The City of Toronto represents 20% of Ontario's population but 38% of its social assistance caseload. Administrative costs of the program are shared 50/50 between the province and the municipality. However, in 2002, the province placed a cap on increases to its share of the administrative costs. Provincial transfers covered only 33% of Toronto's OW cost of administration: The provincial contribution was limited to $55.5 million in 2008, and a full 50% share of the cost of administration would have been $84.2 million.

During the 1990s, several government-appointed panels reviewed Ontario's provincial-municipal fiscal relationship, and recommended that the province assume municipalities' share of the funding burden. In all instances, the provincial government declined to upload these costs. In October 2008, Ontario's present provincial government committed to gradually assume municipalities' share of OW benefits over the next decade with costs fully uploaded by 2018. Additionally, the province assumed full funding responsibility for Drug Benefits in 2008 and will assume full funding responsibility for administration of Disability Benefits in 2009. As well, the province will assume 90% of administrative costs of Disability Support in 2009 and upload these fully in 2011. However, municipalities will still bear 20% of OW benefit costs over 2009 and 19.4% over 2010.[1]

The decision to upload social assistance recognized the fiscal inefficiency of the previous arrangement. While it may be efficient for municipalities to administer social assistance, municipalities' tax bases are poorly suited to fund the system. Property taxes are a highly inefficient means to fund redistribution programs, such as social assistance: Higher property taxes would be required to fund benefit costs in a municipality with a higher proportion of beneficiaries. These taxes could drive residents and businesses to relocate to lower-tax jurisdictions – so-called "voting with their feet." As well, under the present framework, the funding burden for social assistance disproportionately falls on those certain municipalities where cases are concentrated. Moreover, being legally prohibited from running deficits, cities are ill-equipped to finance counter-cyclical income security programs for which expenditures must increase during an economy-wide downturn. Therefore, the McGuinty government's uploading of social assistance is a highly commendable reform.




### Impact on Toronto's Finances in 2009

With the downturn in manufacturing and trade, the 2009 recession will be especially traumatic for households in Toronto, with projected unemployment likely to rise to 9.5% over the next year. Given its high concentration of manufacturing, we anticipate roughly 75,000 job losses in the GTA. Next year, the economy should begin a modest recovery. However, only around 1/3 of this year's job losses are expected to be recouped, and Toronto's unemployment rate will see little alleviation through 2010. Consequently, the City will face additional cyclical pressures – specifically for the funding of social and community services and, in particular, from heightened costs of OW benefits.

The City of Toronto had an average monthly OW caseload of 75,700 during 2008. Total benefit costs were $619 million and administrative costs totaled $168 million. The monthly "churn" within the program is significant: Recipients find employment and leave the program. However, during high unemployment periods, recipients' employment prospects diminish and the outflows from social assistance are greatly reduced. The caseload spikes as newly unemployed individuals and families seek assistance, having exhausted Employment Insurance (EI) benefits or failing to qualify. While the recent federal budget increased the maximum number of weeks for benefits under EI, there was no change to the qualification criteria.[2] These recent EI changes will then not significantly reduce the flows of newly unemployed Toronto workers towards social assistance.

We project that Toronto's average monthly caseload will increase by approximately 18,000 to 20,000 cases in 2009. While substantial, this represents a much smaller increase than the 30,000 jumps in Toronto's OW caseload witnessed during each of 1991 and 1992. We do not anticipate this recession to be as severe as that over 1991 to 1992. As well, the transmission of increased unemployment to an increase in caseload is tempered relative to the earlier period: Social assistance has much more restrictive eligibility requirements today. We compute our caseload forecast based on the historical relationship between Toronto's unemployment rates and new cases to which we have applied our forecast of a 9.5% rate over 2009. By our estimates, a 1% hike in Toronto's unemployment rate translates into a 10% increase in Toronto's social assistance caseload or around 7,500 additional cases. Moreover, Toronto has a high concentration of low-income individuals who are particularly vulnerable to downturns in the trade and support services sectors.

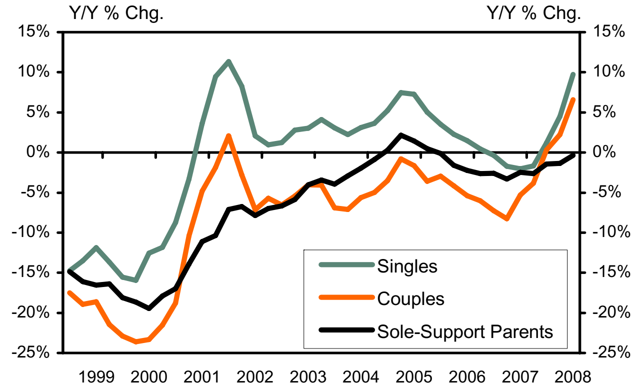
From City of Toronto data, every 1% increase in caseload requires a 1% increase in benefits. 1000 new cases translate into an $8 million increase in benefit costs and an additional $2 million in administrative costs. We project that an additional 16,000 cases would mean $150 to $160 million in additional benefit costs and around $35 to $40 million in additional administrative costs. Toronto is on the hook for 20% of OW benefit costs. Since the province's share of administrative costs has been capped, the City would be responsible for 100% of administrative cost increases. This places the City's total additional cost at $65 to $70 million.

### Low-income Torontonians Remain Vulnerable

Although Toronto has a high concentration of employment in high-wage sectors like financial and professional services, the region also has a high concentration of jobs in support services and retail or wholesale trade. With low wages and unstable employment in these sectors, their workers are particularly vulnerable to this downturn.

We expect that marginally-attached workers will be the first to lose employment during the downturn. With unstable employment, these workers will be the least likely to qualify for EI. Since the EI qualification is based on the prevailing unemployment rate, those laid-off at the beginning of the recession will have the most difficulty qualifying. We therefore expect the impact on Toronto OW system to be front-end loaded with a further jump as EI recipients exhaust their benefits.

**SOCIAL ASSISTANCE BENEFICIARIES BY FAMILY STRUCTURE**




Source: Ontario Ministry of Community and Social Services

Additionally, Toronto is increasingly home to new arrivals to Canada. In 2006, 46% of the population of the Toronto Census Metropolitan Area (CMA) was foreign-born and 8.8% had arrived to Canada in the past five years – a greater proportion of recent immigrants than any other CMA. The difficulties faced by immigrants in integrating into Canadian labour markets are well documented. In 2006, while Canadian-born workers had a low income rates of 9.7%, immigrants who had arrived within the previous two years faced a rate of 34%.[3] Immigrants will be highly vulnerable to unemployment and will face greater difficulty than their Canadian counterparts in regaining employment.

While the Ontario government has embarked on an ambitious poverty reduction strategy, the OW caseload will certainly be impacted by diminished employment prospects. Our forecasts are based on the historical relationships between unemployment, caseloads and total benefit costs. We do control for substantial reductions in benefits and changes to eligibility that occurred in 1995. However, we do not explicitly incorporate the changes to benefit rates made in July 2008 when the Ontario Child Benefit (OCB) was introduced. Alongside the OW benefit restructuring and introduction of the OCB, the Ontario government eliminated the claw-back of the National Child Benefit Supplement (NCBS) from a family's total OW benefits. This meant that total OW payments to any family were not to decrease. Since OCB and NCBS are top-ups, the change should not impact eligibility for OW. The historical relationship between the OW caseload and the overall cost of benefits should not have altered.

However, OW eligibility requires that a beneficiary may only hold limited assets. For instance, a single parent with one dependent is limited to $1,630 in non-exempt assets.[4] For a single individual with no dependents, the limit is $572. We have previously argued that these current asset limits are too low (see: "New Asset and Income policies to assist low-income adults under Ontario's Poverty Reduction Strategy," September 15, 2008). This problem is exacerbated by the failure to adjust these limits for inflation, meaning that the limit has decreased in real terms. The asset limit provides a perverse incentive against recipients accumulating any meaningful cash reserves. This limits their geographic mobility to seek work and inhibits their departure from OW. We believe that current asset limits considerably heighten the persistence of any increases in the OW caseload. Moreover, the asset limits encourage recently laid-off individuals to transfer any liquid assets into exempt forms in order to qualify for social assistance. The low asset limit will likely deny eligibility to certain potential beneficiaries, but we suspect that they will choose to shift or deplete assets in order to qualify. These asset limits are then likely a greater barrier to moving from social assistance than to qualifying for social assistance. Nonetheless, some asset limits have been in place throughout the caseload history that we have used in this analysis, and we control for the tightening of OW eligibility in 1995. We believe our estimates account for the effects of these asset limits.

Lastly, we do note the long-term change in composition of the OW caseload. This could affect overall benefit costs since benefit rates are higher for families than for single unattached beneficiaries. During the past years, single beneficiaries have increased while family beneficiaries have generally declined. However, across Ontario, the year-over-year decline in beneficiaries who are sole-support parents has recently slowed. We expect that families will be increasingly forced onto OW as their employment prospects diminish. Such a shift would place upward pressure on total benefit costs.

### Added Stress on Toronto's Property Taxes

While the provincial government has certainly removed some pressure from the City by uploading other social services expenditures, the tab for social assistance could increase Toronto's overall spending by $65 to $70 million in 2009, and even more in 2010. In order to finance this cost, the City would need to secure spending savings, or increase its revenue base. The City has committed to limit increases to its property tax rates for the commercial and industrial classes at 1/3 of increases to the residential class. Along with complementary non-residential rate increases, each 1% increase in residential property taxes translates into about $15 million in revenues. Therefore, a 4% to 5% increase in revenues from residential property taxes would be required to meet this projected $65 to $70 million cyclical burden. Such an increase in revenues is equivalent to a hike of $75 to $80 per year in taxes on a $300,000 residential property.

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## Endnotes

[1] Facing the Future Together; Provincial-Municipal Fiscal and Service Review, October 2008.

[2] These are based on the prevailing rate of unemployment in the economic region at the time of filing. At Toronto's present 7.2% unemployment rate, a worker must have 630 hours of insurable employment during the past 52 weeks or since the last EI filing. In contrast, in a region with greater than 13% unemployment, 420 hours are required to qualify for EI.

[3] Statistics Canada, "Earnings and Incomes of Canadians Over the Past Quarter Century, 2006 Census," Catalogue no. 97-563-X.

[4] Exempt assets are defined in Ontario Works Directive 4.1 and include the principal residence, motor vehicles (up to $10,000 red-book value), locked-in RRSP, RESP, pensions, and certain other classes.