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Institute on Municipal Finance and Governance



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Provincial-Municipal Relations in Ontario: Approaching an Inflection Point

André Côté and Michael Fenn

Abstract

In Ontario, the history of provincial-municipal relations has progressed from the Baldwin Act of 1849 and the Depression years, to postwar boom and the tumultuous Local Services Realignment of the 1990s. At different points in Ontario's history, the pressures of managing growth, economic restructuring, social and demographic change, environmental sustainability, and shifting public expectations of government have mounted until they reached an "inflection point" – forcing fundamental reforms in provincial-municipal arrangements.

Ontario is approaching another such inflection point. Three major trends are buffeting provincial-municipal arrangements. The first is a growing recognition of the role cities and metropolitan regions play as centres of growth and national prosperity. The second is increasing complexity in the provincial-municipal relationship. The third is the emergence of threats to the fiscal health of Ontario municipalities. These three trends are putting pressure on the scale and structure of governance arrangements and service delivery models in areas of shared provincial-municipal responsibility. As the past has demonstrated, periods of fiscal constraint, as the Government of Ontario is currently experiencing, can be the catalysts for reform.

Keywords: provincial-municipal relations, municipal finance, municipal governance

JEL codes: H71, H72, H77, N91, N82, R51

Provincial-Municipal Relations in Ontario: Approaching an Inflection Point

I. Introduction

Federal-provincial issues such as sovereignty, equalization payments, energy policy, and health care dominate discussions of intergovernmental relations in Canada. But what about public services that are “closer to home” for most Canadians, such as transit, police, and garbage disposal? Despite their lower profile, provincial-municipal relations are no less important. They have important links with economic activity, environmental sustainability, and the safety and vitality of communities. They are complex, politicized, and contentious. Jurisdictional responsibilities and financial authorities are similarly tangled and contested.

A case can be made that municipal systems in Canada receive less attention because of their relative success. Despite recent scandals and isolated examples of wrongdoing or incompetence, municipal affairs in Canada are generally well managed. Local finances are mostly healthy, local services are usually reliable, and urban and suburban growth is largely orderly. Canadian cities have not experienced the “hollowing-out” or dramatic disparities in urban life and public school systems that occurred in major U.S. cities. This, the argument goes, can be attributed in significant measure to the effectiveness of provincial-municipal arrangements.

But this view is oversimplified, given the variety in size and functions among municipal governments. Municipalities differ in their fiscal base and governance arrangements, local circumstances, geography, and economic conditions. Moreover, as municipalities are the constitutional “creatures of the provinces,” each provincial government has its own legislative framework and division of responsibilities with its municipalities. The relationship between these two orders of government is critical: local governments exist under provincial law, they are subject to provincial policies and financial arrangements, and they interact intimately with provinces in the delivery of many services.

This paper argues that the relationship between the Ontario provincial government and Ontario’s municipalities is approaching an inflection point. Provincial-municipal relations have evolved in response to trends in economic and political affairs, society and culture, and urban growth and development. The pressures on these relations, catalyzed by fiscal challenges at the provincial level, have created an opportunity for a fundamental rethink of the relationship and a new conception of how the two orders of government could work together – and in their respective realms.

1.1 The evolution of the relationship

Provincial-municipal relations in Ontario are rooted in two seminal 19th-century statutes: the Baldwin Act of 1849, which established the statutory terms of the

relationship, and the *British North America Act* of 1867. The BNA Act established the distribution of federal and provincial powers that would later be enshrined through the patriation of the Constitution in 1982, placing responsibility for municipal functions under the jurisdiction of the provinces. The legal power and control these pieces of legislation bestowed on the Province, as well as the political culture they have fostered, which emphasizes the subordinate role of the municipal order of government, remain central to the relationship to this day.

Far from being frozen in time, however, the relationship has steadily evolved over the past 150 years. As Ontario industrialized and its urban centres grew, municipalities took on responsibilities beyond the basic functions of maintaining roads, sewers, and streetlights. The dramatic growth of the postwar period and the expansion in the role of government more generally prompted increasing demand for local services and amenities and required the Province to devote greater attention to municipal affairs (Dewing, Young, and Tolley 2006).

Most Canadians now live in urban regions. These regions are the landing spots for immigrants. They are also increasingly recognized as the sources of economic growth and competitiveness, the centres of higher education and innovation, and the places that offer the potential for rising prosperity and quality of life. The increasing complexity of urban life and the linkage between local functions and national and provincial priorities have driven municipalities to assume new roles in a range of substantive policy and program areas – economic development and infrastructure, delivery of complex human services, and climate change adaptation, to name a few. Yet the cliché persists that local governments should focus on garbage collection and pothole repair.

In Ontario, the trend has been towards recognition of the growing size and breadth of municipal operations through reforms to enhance municipal powers, rationalize the relationship with the Province, and increase the efficiency and accountability of local governance. Still, the Province remains firmly in control, limiting the legal and operational flexibility of municipalities in many ways. This is perhaps most apparent in municipal finances, where municipalities have limited access to major revenue sources to supplement the property tax. In addition, the provincial use of conditional transfers defines municipal expenditures on provincial terms, and provincial service standards mandate terms for certain services without requiring the Province to underwrite related operating and capital costs.

1.2 Provincial-municipal relations approaching an inflection point

At different points in Ontario's history, the pressures of managing growth, economic restructuring, social and demographic change, environmental sustainability, and shifting public expectations of government have mounted

until reaching an inflection point, when reforms in provincial-municipal arrangements were required. We are approaching another such inflection point.¹ Three major trends are influencing provincial-municipal arrangements:

- The first is a growing recognition of the role cities and metropolitan regions play as centres of growth and national prosperity, and the need to reform intergovernmental arrangements, devolve responsibilities, and differentiate the treatment of large urban areas from that of small, rural municipalities.
- The second is increasing complexity in the provincial-municipal relationship in Ontario, with a tangled web of actors, responsibilities, service standards, and funding arrangements that create coordination and governance difficulties for both orders of government.
- The third is the emergence of threats to the fiscal health of Ontario municipalities, which have widely varying financial capacities, infrastructure deficits, workforce compensation pressures, and limits on the flexibility and diversity of local revenue sources to meet expenditure challenges.

These three trends are putting pressure on the scale and structure of governance arrangements and the service delivery models in areas of shared provincial-municipal responsibility. As the past has demonstrated, periods of fiscal constraint, as the Government of Ontario is currently experiencing, can be the catalysts for reform.

The next section of the paper describes the evolution of provincial-municipal relations in Ontario. Section 3 makes the case that the intergovernmental relationship has reached an inflection point today as a result of the three trends noted above. Section 4 describes the resulting pressures on provincial-municipal arrangements, outlines implications for the relationship between provincial and local governments, and provides concluding comments.

2. The Evolution of Provincial-Municipal Relations in Ontario

“Those who cannot remember the past are condemned to repeat it.”

—George Santayana, *Reason in Common Sense* (1906, 284)

The provincial-municipal relationship in Ontario has progressed in cycles over the past two centuries (Siegel 2009). While it continues to be strongly influenced by the legacy of 19th-century legal arrangements and political cultures, contemporary economic, social and political trends have dramatically altered the context for the relationship and have continually forced changes on the ground.

2.1 The 19th and early 20th centuries: The formative years

At the end of the 18th century, as the British colonies experienced an influx of Loyalists from south of the border, John Graves Simcoe, the Lieutenant-Governor

1. The Oxford Dictionary defines an inflection point as “a time of significant change in a situation; a turning point.”

of Upper Canada, was determined to avoid the situation that had led to the American Revolution.² He blamed New England's town hall meetings and locally elected municipal councils and school boards for the uprising that led to American Independence. In a letter to the Archbishop of Canterbury in 1790, Simcoe wrote:

Every establishment of Church and State that upholds the distinction of ranks and lessens the undue weight of the democratic influence, ought to be introduced, and will no doubt, in the hands of Great Britain, hold out a purer model of government in a practical form, than has been expatiated upon in all the theoretic reveries of self-named philosophers (Bliss 1966).

In 1792, recognizing the need for more local decision-making in Upper Canada, Simcoe opted for an elite-based administrative model. It was built around Courts of Quarter Session, where justices of the peace appointed by the colonial administration decided local political issues and made decisions about community service delivery. The system was more familiar to the Loyalists who had come from the southern and mid-Atlantic colonies than it was to those from Pennsylvania, upstate New York, and New England.

In the early decades of the 19th century, attempts by Reformers in Upper Canada's Legislative Assembly to pass a Municipal Act had been resisted by the Tories in the Governing Council, the group known as the Family Compact. By 1832, the effectiveness of the Courts of Quarter Session had collapsed under growing demands, and the issue of municipal self-government was an important grievance leading to the Rebellion of 1837 in Upper Canada.³ In 1834, Toronto had finally been given the authority to elect a mayor and municipal council. As if to confirm Tory fears, however, within three years of being elected Toronto's first mayor, William Lyon Mackenzie led the Rebellion of 1837. When Robert Baldwin and Louis-Hippolyte Lafontaine attempted to implement municipal legislation a decade later, citing the findings in Lord Durham's report on the causes of rebellion in the Canadas, they were opposed by legislators who feared a repeat of the actions of Mackenzie and his municipal colleagues.

In the context of today's civic apathy and low municipal voter turnouts, it may be hard to imagine Ontarians taking up arms and risking the gallows to demand institutions of municipal government. But in the early days of Upper Canada's settlement, infrastructure and local services were crucial for family and community survival. Unwilling to rely on Simcoe's centrally managed decision-making process, farmers and townsfolk demanded control over their own affairs, as well as the financial and legal capacity that went with authority (Crawford 1954).

2. In 1791, the British parliament passed the *The Constitutional Act*, which created the provinces of Upper and Lower Canada and established a lieutenant governor in each province. This official, appointed by the Crown, had an executive council to advise him, a legislative council that acted as an upper house, and a representative assembly whose members were elected by the people but had limited authority.

3. This was noted by Lord Durham in his Inquiry into the causes of the Rebellion.

2.2 From local self-determination to the Great Depression

With the passage of Baldwin's *Municipal Corporations Act* (the "Baldwin Act") in 1849, the colonial legislature established a general system of local government. The Baldwin Act was the British Empire's first statute establishing comprehensive and democratic municipal self-government. It repealed existing municipal charters and established villages, towns, and cities as municipal entities differentiated by size, while recognizing counties and townships as units of rural government. It was the practical product of mid-19th-century trends – notably the need for infrastructure investments to support economic expansion, along with the need for the colonial government to shift some of this expenditure off its own books. The trends were supported by growing recognition that local governments were needed to accommodate the stresses of early urbanization and demands for new services (Tindal and Tindal 2004).

For much of the 19th and early 20th centuries in Ontario, devolved local self-government was the norm. Once southern Ontario was surveyed and trunk roads were built under the direction of the British military, local communities were left to make the important decisions about roads and bridge-building, and, later, about water, wastewater, and stormwater management, solid waste disposal, electricity distribution, natural gas franchises, the building and financing of regional and local railways and transit systems, and the provision of public welfare ("poor relief," public health inspections, quarantines and inoculations, and homes for the aged).

Of equal importance, local governments were awarded the fiscal authority to tax the growing real estate wealth of their farms and communities through property taxation. In an era before income and sales taxes, property tax made sense: most municipal functions were services to property, so a tax on property was the most appropriate way to fund them. The tax also justified restricting the right to vote in municipal elections and bond-issuing referenda to local property owners.

The second foundational piece of legislation governing the relationship between the province and municipalities had a different legacy. The *British North America Act* of 1867 did not recognize municipalities as orders of government, placing "municipal institutions" under the powers of provincial legislatures. Municipal incorporation, authorities, and revenue-raising capacity remain at the sole discretion of provincial legislatures to this day.

In the decades that followed Confederation, Ontario underwent industrialization, large-scale immigration, and a residential and commercial construction boom. The population of the City of Toronto grew from 50,000 in 1860 to 200,000 by 1900.⁴ This level of growth put significant pressure on municipalities to invest in water and sewer infrastructure, roads, transit, and electricity utilities, as well as creating demand for new services such as schools, libraries, and street lighting.

4. Canadian census, various years, compiled by Zack Taylor. Other parts of this section were informed by Zack's doctoral research as well.

In the late 19th and early 20th century, many municipalities became embroiled in unsustainable railway schemes aimed at using local governments to finance employment-generating railway spurs to serve their towns and markets. The Ontario Railway and Municipal Board (ORMB) – the precursor to the Ontario Municipal Board (OMB) – was established in 1897 to regulate the activities of intercity and local street railways that were in constant conflict with local councils. Its mandate evolved to include oversight of public utilities, property tax assessment adjudication, the approval of land use plans, and the regulation of services such as local telephone systems, gasworks, public parks, and motor vehicle registration.

The 1930s brought the period of rapid urban and suburban growth to a crashing halt. Canadian municipalities had been reckless borrowers during the 1920s and faced severe debt and default problems as the Great Depression took hold. The gross debt of Canadian municipalities had grown by 90 percent between 1920 and the early 1930s – and by nearly 110 percent in Ontario. American scholar A. M. Hillhouse noted at the time that about 10 percent of Canadian municipal debt was in default in 1932, compared with only 3 to 5 percent south of the border. By 1935, 20 percent of Ontario municipal debt was in default (Hillhouse 1936). During the early 1930s, more than 40 Ontario municipalities and school boards defaulted on their obligations.

The high levels of municipal indebtedness were compounded by falling property assessment, poor administration, and delinquency among taxpayers. Half of the municipal property tax levy was in arrears by 1934. Municipalities were required to invest in unfunded or partially funded provincial mandates such as water and sewer services. Adding to the burden was the obligation to provide unemployment relief payments to the poor (Weaver 1979). Municipal public welfare expenditures more than doubled between 1926 and 1937 (Tassonyi 1994).

The response in Ontario was provincial intervention and increased supervision. The Department of Municipal Affairs was created to oversee municipal finances and the rebranded Ontario Municipal Board (OMB) was given broad new powers over municipal fiscal management and borrowing. In 1935, the Province forced the merger of a number of insolvent municipalities to create the enlarged City of Windsor (Tassonyi 1994).⁵ Provincial interventions to stabilize municipal finances ran counter to the trend in the United States, where the “home rule” tradition and lower levels of municipal fiscal turbulence created the conditions for further devolution of powers.

2.3 Ontario’s postwar urbanization and its impacts

The dramatic growth of Ontario’s urban and suburban regions after the Second World War required the expansion of infrastructure and social services. By the late

5. Many of the defaults were in burgeoning suburban municipalities around Toronto and Windsor, which overbuilt during the 1920s and endured real estate crashes (Hillhouse 1936).

1960s, the provincial population had reached seven million, much of it concentrated in a few large metropolitan centres. Existing governance and fiscal arrangements became an impediment to managing growth. The 1967 report of the Smith Committee on Taxation observed that many municipal governments were too geographically and structurally fragmented to plan, coordinate, and deliver local and regional services effectively. Given their expanding portfolio of responsibilities, they were also overly reliant on the property tax, lacking other revenue tools (Smith 1967).

Recognizing that the pressures of growth and service coordination required new governance arrangements and a larger geographic footprint for municipalities, the Government of Ontario created “regional” governments. Starting with Metro Toronto in the early 1950s, and continuing with other urban regions in the late 1960s and early 1970s, the Province created two-tier or “federated” municipal government structures. These regional municipalities (and their counterparts, regional school boards) were to plan, manage, and finance urban development and, through cost-sharing arrangements, promote regional social equity in education, social services, and public health.

Despite continued calls for greater local autonomy and authority, Provincial officials saw political risks in providing additional local powers. The Government of Ontario did establish the Provincial-Municipal Liaison Committee to serve as a mechanism for formal public dialogue between governments. This body was relatively short-lived, however, and the Province ignored the demand for a more robust municipal role in intergovernmental relations for another two decades.

2.4 The Government of Canada's role in urban affairs

The 1970s saw a brief period of federal intervention in urban affairs. The primary vehicle for federal-provincial-municipal cooperation had long been the Canada Mortgage and Housing Corporation (CMHC), which underwrote postwar suburban residential expansion and shared the responsibility for funding and managing social housing. The Liberal government of Pierre Elliott Trudeau created the Ministry of State for Urban Affairs (MSUA), and the Prime Minister even expressed his openness to municipal constitutional recognition. But by 1979, provincial opposition led to the abolition of the MSUA and firm rejection of any notion of municipal recognition in the constitution (Dewing, Young, and Tolley 2006).

Municipal advocacy for intergovernmental and constitutional recognition during this period, best expressed through the Federation of Canadian Municipalities, was “largely motivated by [municipalities’] search for practical ways of meeting the increasing demands upon their fiscal resources” (Dewing, Young, and Tolley 2006, 1). The provincial and federal governments responded to this municipal need, increasing transfer payments by 102 percent between 1968 and 1973. However, the increase in municipal fiscal transfer dependence – often as conditional grants – did not satisfy municipal leaders who sought greater financial autonomy (O’Brien 1975). One-time funding for capital investments also placed new financial burdens on municipalities left to operate and maintain new infrastructure.

This period of urban tumult during the 1970s was followed by a decade and a half of relative calm as the rise of the Québec sovereigntist movement and the election of the Parti Québécois created a significant cooling in the federal inclination to engage in municipal policy spaces. Furthermore, the focus through this period was on deficit taming, climaxing in the mid-1990s with a 1995 federal budget that significantly reduced transfers to provinces (Cameron 2002).

2.5 *The restructuring and realignment of the 1990s*

The broad narrative of the 1990s holds that the provinces, facing severe fiscal difficulties themselves, passed these transfer reductions to local governments. While this trend is difficult to assess across the country, it is clear that the fiscal crisis was one of a few drivers of the dramatic reforms that unfolded in Ontario. During the late 1990s and early 2000s, Ontario's Progressive Conservative government undertook three major reforms in the municipal sector: a unilateral realignment of responsibilities between the provincial and local levels; the halving of the number of municipal governments through a policy of restructuring and amalgamations; and a comprehensive reform of the property tax system. The result was "some of the most turbulent provincial-municipal relations ever experienced in a Canadian province" (Graham and Phillips 1998, 176).

Some of these changes contradicted advice provided by several expert advisory commissions. The first was an advisory committee chaired by Grant Hopcroft, convened in 1991 to review provincial-municipal financial arrangements, which recommended that responsibilities be disentangled to allow municipalities to focus on traditional local functions and that local governments have access to adequate sources of revenue to fund their responsibilities, with provincial use of conditional transfers warranted only where services remained a shared responsibility (Hopcroft 1991).⁶

In 1996, another provincially appointed task force, chaired by Anne Golden and mandated with providing direction on the future governance of the Greater Toronto Area (GTA), recommended merging five GTA upper-tier governments into a single Greater Toronto regional body that would be responsible for high-order land-use and transit planning, economic development, highways, and infrastructure. At the same time, the powers and responsibilities of the lower-tier municipalities would be broadened to ensure the governance model would be responsive locally (GTA Task Force 1996).

Finally, the Who Does What Panel that same year recommended reforms to create a more flexible, permissive legislative framework under the *Municipal Act*, and a GTA services board to coordinate regional activities. The Panel also called for the Province to assume full control and funding responsibility for health services

6. The report did not endorse major new revenue sources such as income, payroll, or sales taxes, but did recommend providing access to hotel, parking, or environmental taxes. It also called for more local governments to be provided with more flexibility for innovative asset management arrangements and public-private partnerships.

(such as public health and long-term care homes) and redistributive human services (such as welfare, support-payments to the disabled, employment supports, and child care) (Who Does What Panel 1996).

During the provincial reforms that followed, some of this advice was heeded, but many key recommendations were ignored. Local Services Realignment (LSR), which its opponents called “downloading,” took effect in January 1998. Municipalities were required to assume partial or full funding responsibility for social services such as social housing, disability supports, the seniors’ drug benefit, and child care, as well as for municipal transit, public health, land ambulance, and property assessment (see Table 1). The Government of Ontario also intervened in the public education system, reorganizing school boards and their boundaries, limiting the authority of elected trustees, and assuming control over education funding, including the residential and business education property taxes.

Education property taxes were reduced as part of the realignment, ostensibly leaving the municipalities with tax “room” to fund the new municipal program expenses transferred to them. A transfer payment program, the Community Reinvestment Fund (CRF), was created to support local fiscal capacity with the objective of overall “revenue neutrality” in the service restructuring. Experts disagree on whether the restructuring was actually revenue-neutral across the province.

Table 1: The Effects of Local Services Realignment (LSR), 1998

Responsibility	Pre-LSR		LSR	
	Provincial	Municipal	Provincial	Municipal
Social Assistance (Ontario Works or OW)	80%	20%	80%	20%
<i>Social Assistance Administration</i>	50	50	50	50
Ontario Disability Support Program (ODSP)	100	0	80	20
Child Care Services	100	0	80	20
<i>ODSP & Child Care Administration</i>	100	0	50	50
Ontario Drug Benefit (ODB)	100	0	80	20
Public Health*	75	25	50	50
Land Ambulance**	100	0	0	100
Social Housing	100	0	0	100
Municipal Transit Costs***	33	67	0	100
Property Assessment	100	0	0	100
Sewer & Water	10	90	0	100
Policing	10	90	0	100
Farm Tax & Conservation Lands Tax Rebates	100	0	0	100
Children’s Aid Societies	80	20	100	0

*Public health costs were returned to the pre- LSR 75- 25% shares in 2007.

** The land ambulance funding share was shifted to 50-50% in 1999.

***GO Transit was completely devolved to municipalities, only to be re-assumed by the Province in 2002.

The second major reform involved municipal amalgamations. The rationale was to increase the efficiency and accountability of local governments, to achieve cost savings through economies of scale, and to ensure that municipalities had the fiscal capacity to accommodate Local Services Realignment. Amalgamation was generally imposed on unwilling local municipalities, although some were persuaded to restructure on a voluntary basis as an alternative to enforced solutions. The two-tier municipalities of Metro Toronto, Ottawa-Carleton, Hamilton-Wentworth, and Greater Sudbury were amalgamated into single-tier cities. Many smaller amalgamations took place as well, often in two-tier county systems.⁷ In all, between 1995 and the early 2000s the number of municipalities in Ontario was nearly halved from around 850 to 444 (Found 2012).

The third major reform was to the property tax system. An antiquated assessment and tax system had resulted in growing inequities among homeowners and across property classes. The 1998 reforms had two main components. The first was the shift to a uniform, province-wide system of “current value assessment” (CVA) that sought to capture a true market rate for real property.⁸ The assessment function was transferred from the province to what is now known as the Municipal Property Assessment Corporation (MPAC), a non-profit corporation with membership composed of all municipalities.

The second component was a classified property tax structure, which allowed municipalities to set different rates across seven different classes of property, with rate reductions required on certain sub-classes such as vacant commercial and industrial lands and farmland and managed forests. Several optional property classes were also created, for a total of up to 36 different property classes and sub-classes. The new system included transition and rate-capping mechanisms, and allowed for three separate commercial and industrial rate “bands.” The complexity of the classification system resulted from a desire to minimize large shifts in tax burden caused by the new assessment system and the resulting political ramifications.⁹

David Siegel has suggested that the changes between 1996 and 1999 represent the “most comprehensive reform of municipal government since 1849” (Siegel 2004, 182). The results have been mixed. The property tax reforms, despite some problems, represented a needed modernization of the assessment regime in the province. The municipal property tax room that accompanied the uploading of

7. For example, amalgamation was imposed on the 23 municipalities in the Kent County–City of Chatham area, creating a single-tier municipality – a development that prompted a spate of “voluntary” restructuring in other parts of the province, to avoid a similar fate.

8. Current Value Assessment is synonymous with the terms Market Value Assessment or Actual Value Assessment.

9. The seven different property classes were residential, multiresidential, commercial, industrial, pipelines, farms, and managed forests, as well as optional classes such as new multiresidential, office buildings, shopping centres, parking lots, and large industrial properties (Bird, Slack, and Tassonyi 2012).

education costs increased municipal use of own-source revenues, while the unconditional transfers through the Community Reinvestment Fund (CRF) and other policies such as the “pooling” of social services costs among suburban municipalities in the GTA helped equalize for the fiscal deficiencies of poorer local governments.¹⁰

Packaged with Local Services Realignment and amalgamations, however, the property tax reforms were unpopular. The fiscal changes came at the expense of function-specific capital and operating grants and created major swings in property assessment valuations among municipalities and classes of taxpayers. The results were predictable: the “winners” were quiet and enjoyed a diffuse, often incalculable benefit, and the “losers” – older cities, transit operators, social housing providers, some classes of taxpayers – were vocal in their protests. A comprehensive 2012 review of the property tax reforms concluded that the jury is still out on whether they have been a success. The shift to a uniform, market value assessment system was needed, but the numerous property classes and rates have created complexity and administrative burden for municipalities, and prompted additional reforms in the decade since (Bird, Slack, and Tassonyi 2012).

The provincial reforms also failed in some important respects. The amalgamations did not address the critical need for metropolitan governance mechanisms in the GTA, and the evidence does not suggest that they achieved cost savings (Slack and Bird 2013).¹¹ Finally, in spite of the recommendations of the Hopcroft, Golden, and Who Does What advisory bodies, Local Services Realignment further entangled service delivery responsibilities and saddled local governments with the costs of some social services without the commensurate revenue-raising mechanisms, setting the stage for further realignments over the next decade.

2.6 The 2000s: Unshackling? Or creeping fiscal dependence?

The upheaval of the late 1990s was followed by another period of relative calm, as local governments adapted to the structural reforms and service realignments, and the provincial government increased its investments in municipalities. The Liberal government, elected in 2003, sought to rebuild the relationship, in part through significant reforms to the municipal legislative framework. There were growing pains for local governments across the province as the newly amalgamated cities of

10. The concept of “pooling” within the GTA recognized that the cost of human services was higher in the City of Toronto because of the number of recipients and the range of programs, whereas the tax resources of the GTA economic region favoured the surrounding regional municipalities. A statutory formula was developed to “pool” tax assessment resources across the GTA, and redistribute the resulting tax revenues in a way that recognized the higher costs in Toronto. The Province began to phase out the GTA pooling transfers in 2007, replacing them with a provincial compensation grant for Toronto (See City of Toronto 2013a).

11. Amalgamations did, however, allow for a more equitable sharing of the tax base within the enlarged cities and some other benefits.

Toronto, Ottawa, Hamilton, and Greater Sudbury sought to merge local functions and create new political and administrative systems. For regional municipalities in Southern Ontario and the Greater Toronto Area, the primary concern continued to be managing growth in population, service demands, and land use. Rural and northern municipalities faced different challenges, as small and often shrinking populations, a limited or declining industrial tax base, and unreduced expectations for public services strained their capacities.

The early 2000s also marked a brief resurgence in federal interest in municipal affairs. Prime Minister Paul Martin's Liberal government identified a "New Deal for Canada's Communities" as one of its major priorities. John Godfrey, appointed Minister of State for Infrastructure and Communities, identified three components of the New Deal: stable long-term funding, sustainable relationships, and a commitment to look at federal activity through an urban lens. In a speech to big-city mayors, Godfrey noted that "the municipal agenda – both large and small – is at the heart of the federal government's priorities" because municipalities foster Canada's prosperity and deliver an array of social programs (Godfrey 2004). The 2004 budget made several funding commitments to local governments, including a municipal Goods and Services Tax (GST) rebate, infrastructure funding, and a promise to share the federal gas tax (see Table 2).

Nevertheless, the provinces and territories resisted federal incursion into the municipal realm. In 2004, they proposed that federal programs be developed following consultation and agreement with the provinces, fall under federal-provincial agreements, and respect the provincial role in consulting with their own municipalities (Dewing, Young, and Tolley 2006). With the election of the federal Conservatives in 2006, the provinces' wishes have largely been realized. The Conservative government's commitment to "Open Federalism" signalled a return to a more clearly delineated division of responsibilities along constitutional lines. Still, the federal government committed significant funding for local infrastructure, including stimulus funding in the wake of the 2008 financial crisis. The 2013 federal budget announced a continued federal commitment to infrastructure funding, flowed through the municipal Goods-and-Services Tax (GST) rebate and an enhanced Gas Tax Fund, as well as the renewed Building Canada Fund and Investment in Affordable Housing programs (Government of Canada, Department of Finance 2013).

2.7 A new phase in the provincial-municipal relationship

The last decade also saw the most significant reform of the statutory relationship between the Ontario government and its local governments since the Baldwin Act. The increased size, role, and complexity of local governments led to the first new legislation regulating provincial-municipal affairs in 150 years, the *Municipal Act*, 2001, and unique treatment of the province's largest local government under the *City of Toronto Act*, 2006. These two pieces of legislation created a "permissive" policy framework that provided additional flexibility, less prescriptive "natural-

Table 2: Major Federal Transfers to Ontario Municipalities

Program	Overview	Ontario Funding (Timing)
Infrastructure		
<i>Full Refund of the GST for Municipalities</i>	A permanent program provides a 100 percent rebate of the federal portion of the HST (Ontario provides a 78 percent rebate for provincial portion).	~\$280 million for 2013-14* (permanent)
<i>Gas Tax Fund (GTF)</i>	The GTF provides \$2 billion annually to fund eligible infrastructure projects. The 2013 federal budget indexed the GTF to grow by 2 percent starting in 2014, and expanded eligibility to include almost all municipal infrastructure.	\$750 million per year, indexed to grow by 2 percent annually (permanent)
<i>Building Canada Fund</i>	Budget 2013 renewed and extended the BCF from the current 7 years to a new 10 year program. The matching grant program is allocated on a 'base plus population' formula.	~\$500 million per year* (10 years beginning in 2014)
<i>Other infrastructure programs</i>	Other major programs include the P3 Fund, Green Infrastructure Fund (GIF) and the Community Infrastructure Investment Fund (CIIF)	~180 million per year* (timing varies)
Housing		
<i>Canada-Ontario Investment in Affordable Housing (IAH)</i>	A cost-shared program that provides funding for new construction, renovation, homeownership assistance, shelter allowances, and other supports. New housing must remain affordable for a minimum of 20 years.	\$480 million from 2011-2015 (extended to 2018-19)
<i>Federal social housing operating agreements</i>	The long-term agreements (25 to 50 years) with housing providers provide federal operating subsidies for over 200,000 units in Ontario. The agreements generally end when mortgages are paid.	Nearly \$500 million per year (declining until the expiry of all agreements by 2032)

*Approximate funding amounts for Ontario calculated on the basis of per capita population.
 Sources: 2013 Federal Budget; Federation of Canadian Municipalities; Ontario Long-Term Affordable Housing Strategy; Ontario Public Accounts 2011-12; Association of Municipalities of Ontario

person” powers for municipal corporations, and other measures to augment the autonomy of local governments. Reforms to the *City of Toronto Act* also provided the province’s largest local government with modest new taxation powers.¹²

Provincial policy has also taken an increasingly regional lens. The Greenbelt Plan, 2005, and the Growth Plan for the Greater Golden Horseshoe, 2006, were established to address the challenges of growth management and suburban expansion in Central Ontario. The Growth Plan for Northern Ontario, 2011, focused on stimulating investment and economic diversification, but took a similar approach in creating a broad regional policy framework within which

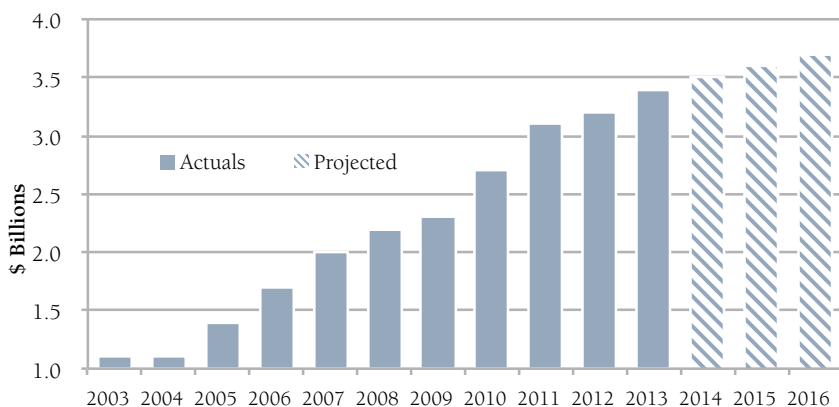
12. The Act allows the City to tax land transfers, vehicle registration, billboards, retail alcohol sales, and entertainment, but not more significant tax bases such as retail sales, income, gasoline, or payrolls.

municipalities make their own choices.¹³ Finally, the Province created Metrolinx, a Crown agency set up to develop and implement a regional transportation strategy and manage and expand the commuter rail and bus network in the region surrounding Toronto.

The negotiation of a Memorandum of Understanding between the Province and the Association of Municipalities of Ontario (the AMO MOU) created a formal, ongoing reporting and consultation mechanism for discussing policy and regulatory reforms. The City of Toronto is the only municipality to manage its relations with the Province outside this arrangement. A Toronto-Ontario Cooperation and Consultation Agreement and the *City of Toronto Act* represent the Province's recognition of the need for an asymmetrical relationship with Ontario's largest city (Siegel 2009).

The past decade has also seen considerable provincial investment in the municipal sector (see Figure 1). Between 1999 and 2007, the Province re-assumed the costs of GO Transit and much of public health (earlier devolved as part of Local Services Realignment), followed by the costs of land ambulance service. In 2005, the Ontario Municipal Partnership Fund (OMPF) replaced the Community Reinvestment Fund. The OMPF is an unconditional transfer program with a significant equalization component. It targets funding to small, rural, and northern communities with poorer fiscal capacity. In 2007, the Province also began lowering

Figure 1: Provincial Support to Ontario Municipalities



Source: Provincial-Municipal Fiscal and Service Delivery Review; Ontario Ministry of Finance; adjusted to reflect the OW administration funding model announced in 2011, the phase-down of the OMPF confirmed in the 2012 and 2013 Ontario Budgets, the phase-out of Toronto Pooling Compensation and updated projections.

13. Regional programs include the Northern Ontario Heritage Fund and the Northern Industrial Electricity Rate Program, and economic development grant programs targeted to the eastern and southwestern parts of the province.

business education property tax rates to reduce the burden on business and increase room for municipalities to increase their property tax rates.

The Province has provided considerable support for municipal infrastructure. Time-limited federal-provincial cost-shared programs have provided significant new funding. The provincial gasoline tax transfer was introduced in 2004 to support municipal transit infrastructure needs.¹⁴ The Province has committed to permanent gas tax funding of \$318 million annually (McNamara 2012). There were also one-time, year-end investments during the mid-2000s, as required under the *Investing in Ontario Act* when the provincial budget was running a surplus. Since 2003, provincial support for municipal infrastructure has totalled more than \$12 billion, not including the significant federal component of cost-shared investments (Commission on the Reform of Ontario's Public Services 2012).

The most significant increase in provincial support came through the “uploading” of municipal costs as part of the Provincial-Municipal Fiscal and Service Delivery Review. A joint process of research, analysis, and negotiation between the Province, the Association of Municipalities of Ontario (AMO), and the City of Toronto, the two-year initiative focused on opportunities to realign the funding and service delivery relationship, notably for social services. The outcome was a provincial commitment to upload the municipal funding share of benefit costs for social assistance programs – Ontario Works (OW) and the Ontario Disability Support Program (ODSP) – seniors' drugs, and court security costs. The net benefit to municipalities will be \$1.5 billion per year by 2018.

In addition to the fiscal realignment, there was also agreement to pursue other priorities, including infrastructure investments and improved municipal asset management, the modernization of low-income supports, and the consolidation and integration of provincial-municipal programming in the areas of housing and homelessness, child care services, and social assistance and employment supports (Provincial-Municipal Fiscal and Service Delivery Review 2008; see Table 3).

This substantial increase in provincial support for municipalities was the most important trend of the past decade. From 2003 to 2010, without including one-time infrastructure transfers, provincial funding support grew by almost 150 percent, or by nearly 14 percent annually (Commission on the Reform of Ontario's Public Services 2012). The Province also provided local authorities with some additional flexibility in their spheres of responsibility and made efforts to rationalize the alignment of service responsibilities. These efforts at legislative unshackling and partnership were important symbolically and in some practical respects. But the Province remained unwilling to relinquish control over key policy levers and local finances.

14. The Province transfers two cents per litre from gas tax revenues to municipalities, based on a formula weighted to transit ridership volume.

Table 3: Provincial Upload Schedule

Program	Upload Status	Prov. Share 2007	Complete*
Ontario Drug Benefit (ODB)	Complete	80%	2008
Ontario Disability Support Program (ODSP) Administration	Complete	50%	2009
ODSP Benefits	Complete	80%	2011
Ontario Works Benefits	Began in 2010	80%	2018
Court Security Costs	Began in 2012	14.3%	2018

*Provincial share equals 100%

3. Provincial-Municipal Relations: Approaching an Inflection Point

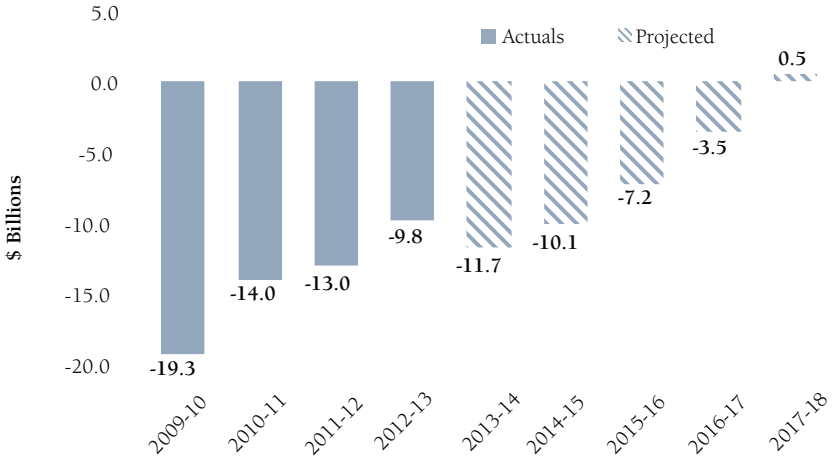
The financial crisis of 2008 ushered in a new era of slower economic growth, uncertainty in financial and credit markets, and alarming deficits and public debt levels. While Canada fared relatively well during this period, it has not been spared from these problems. Ontario in particular has suffered a decline in its fiscal situation from a budget surplus in 2007 to a \$20-billion deficit in 2009. As we have seen in the past, fiscal challenges are usually a major catalyst – if not *the* catalyst – for big shifts in provincial-municipal relations.

The provincial fiscal situation should concern Ontario municipalities, given the highly interconnected nature of provincial-municipal fiscal arrangements and the reliance on provincial largesse in recent years. At the same time, three major trends are having a growing influence on intergovernmental arrangements. The first is a growing recognition of the role cities and metropolitan regions play as the centres of growth and national prosperity. The second is increasing complexity in the provincial-municipal relationship. The third is the emergence of threats to the fiscal health of Ontario municipalities.

3.1 Provincial constraint as a catalyst for change

The Commission on the Reform of Ontario's Public Services (Drummond Commission) noted in its 2012 report that achieving Ontario's 2017–18 fiscal target without major tax increases will require program spending to be cut “more deeply on a real per capita basis, and over a much longer period of time, than the Harris government did in the 1990s” (Commission on the Reform of Ontario's Public Services 2012, 10). For 2013–14, the government has projected a budget deficit of \$11.7 billion, or 1.5 percent of GDP. Over the next three years, the fiscal plan commits to holding average annual expense growth to just 1.5 percent. The pain will not be shared equally. While the health, education, post-secondary, and social services sectors will grow at over 2 percent annually, other expenditure areas are to *decline* by more than 4 percent annually between 2012–13 and 2015–16 (Ontario Ministry of Finance 2013; see Figure 2).

Figure 2: Ontario's Fiscal Plan



Source: Ontario 2013 Budget

Funding to municipalities is projected to grow at more than 5 percent annually until 2018. One of the Drummond Commission's many recommendations was to reduce support for the municipal sector by slowing the pace of the social-services "upload," as it is far above the program spending growth rates the Commission recommended. To date, the Province has committed to continuing with the upload schedule, although the 2012 budget announced the phased reduction of unconditional transfers and a freeze in the provincial business education tax rate reductions (Ontario Ministry of Finance 2012). In 2013, the Province also announced that \$150 million in compensation to the City of Toronto for the loss of social services pooling would be wound down by 2016 (Church, Morrow, and Howlett 2013).

The most obvious risks for municipalities are further reductions in provincial transfers or delays in existing commitments, potentially including the pace of uploading social assistance and court security costs that run until 2018. The Province could transfer new, unfunded responsibilities to municipalities, such as responsibility for the administration of disability supports. Provincial inaction in certain sectors could also have grave consequences, worsening underinvestment in critical local infrastructure such as transportation systems and social housing stock.

3.2 Cities as drivers of growth and innovation

The rapid pace of urbanization and shifting conceptions of the role of cities and metropolitan regions are having a profound impact on economies and governance

arrangements around the world. Given the growing consensus that the success of city-regions and their agglomeration economies drives national economic competitiveness and prosperity, intergovernmental arrangements are being reformed to decentralize responsibilities and differentiate between the needs and treatment of large, complex city-regions and small, rural municipalities.

City-regions as economic engines

The disproportionate share of economic activity and investment in cities is requiring that national and sub-national (provincial or state) governments reconsider intergovernmental arrangements and their treatment of cities and metropolitan regions. A recent report by the Brookings Institution and the London School of Economics (LSE) Cities Program notes that, increasingly, “the economy is not organized at the super-regional or national levels, but rather in the cities and metropolitan areas that make distinctive contributions to global growth and prosperity” (Istrate and Nadeau 2012, 2). The McKinsey Global Institute (MGI) projects that, by 2025, the top 600 cities in the world will generate nearly 60 percent of global GDP with only 25 percent of the world’s population. Accordingly, the consultancy is advising multinational companies that identifying the metropolitan regions that offer the most promising conditions should be a primary strategic objective (Dobbs et al. 2011).

In developed countries, major urban regions generally have higher GDP per capita and productivity levels than the national average. This outsized economic impact is the result of agglomeration economies: the concentration of the critical factors of production, such as human and physical capital, business services, infrastructure, research and development, and innovation. These regions also benefit from the advantages of both specialization and diversity in labour markets and industry clusters (OECD 2006). These factors help cities and city-regions attract global foreign direct investment, which boosts productivity and growth, supports capital formation and job creation, increases tax revenues, and provides “spillovers” such as access to more advanced technology. The benefits of vibrant city-regions flow to surrounding regions and across the country (Arcand 2012).

The implications for policymakers are clear. The conditions must be in place to enable metropolitan areas to succeed. Partnerships with national and sub-national governments, as well as with other city-regions, are essential in establishing “collaborative advantage” (Istrate and Nadeau 2012, 1). An important ingredient is ensuring that cities have the fiscal capacity to provide services and infrastructure to attract talent and investment (Conference Board of Canada 2008). Thomas Courchene has argued that because Canada’s economic competitiveness and standard of living increasingly depend on how our city-regions fare relative to international counterparts, enhancing the fiscal powers of cities and their standing in the sphere of Canadian federalism should be a key priority for federal and provincial governments (2004). It is also important for governments – especially municipal governments – to participate with the private sector in contributing to the rate of productivity improvement in Canada and its economic regions.

The growing global trend towards decentralization

Urbanization and the outsized economic role of city-regions are creating pressures to reform fiscal and governance arrangements to foster the conditions for economic growth and social progress. The trend line has not been smooth, but it has been steadily heading towards the decentralization of responsibilities to local governments. There has been a “silent revolution” of decentralization reforms since the 1980s, inspired by a desire to move decision-making closer to people and improve the fairness, accountability, and responsiveness of governance (Ivanyna and Shah 2013).

This shift has been born of both principle and pragmatism. The theory of decentralization advanced by Wallace Oates proposed that public services be provided by the jurisdiction that can best internalize the costs and benefits of provision (1972). This view aligns with the concept of “subsidiarity,” commonly held in Europe, that the management of public responsibilities should rest with institutions as close to the citizen as possible. The case for decentralization is premised on the propositions that local governments have superior access to local information compared with higher-order governments, allowing them to better respond to local needs; and that this proximity to the citizen creates stronger incentives to perform well, get better value for public resources, and encourage openness to innovative solutions.¹⁵ The theory is supported by a recent study of fiscal federalism across countries, which found that decentralized spending and, in particular, revenue-raising functions are positively associated with economic activity, investment in physical and human capital, and other positive outcomes (Blöchliger 2013).

At the same time, as the scope of activities in urban areas has increased, national and sub-national governments (that is, state or provincial governments) have pragmatically sought to devolve complex and resource-intensive functions, empowering local authorities to deal with them. Reforms to local government tax systems are under way in France, Ireland, and the Slovak Republic to, among other things, increase local fiscal responsibility and the predictability of municipal revenues, while the Czech Republic is reforming its transfer system to increase the equalization component and better align delegated responsibilities with local revenue needs (Vammalle and Hulbert 2013).

Intergovernmental relations in the United States are also in transition. In *The Metropolitan Revolution*, Bruce Katz and Jennifer Bradley of the Brookings Institution argue that the traditional intergovernmental construct, where the federal and state governments are the adults that set the terms and allocate the dollars for their local government children, is being swept away (2013). Faced with a range of financial and service delivery challenges – and receiving little help from

15. Critics do rightly point out that for some public services, local provision can undermine regional equity or create fragmentation and spillover externalities across local borders within an economic region (United Cities and Local Governments 2010).

fiscally stretched and politically gridlocked senior orders of government – cities and metropolitan regions are embracing a new role as policy leaders and innovators. In Cleveland and Northeast Ohio, for example, after decades of manufacturing decline, local governments, civic leaders, business groups, and philanthropic organizations have partnered to shape a regional economic development strategy with a locally seeded investment fund to plan and support the transition to new, advanced industries. The leaders of a fragmented array of city and county governments in Greater Denver have created a Metro Mayors Caucus to enable collaboration and regional planning. According to Katz and Bradley:

The tectonic plates of power and responsibility are shifting. Across the nation, cities and metros are taking control of their own destinies, becoming deliberate about their economic growth. Power is devolving to the places and people who are closest to the ground and oriented toward collaborative action (2013, 5).

Decentralization has also been a major priority in the United Kingdom, where the increasingly centralized unitary state has been recognized as a barrier to good local governance and economic progress. The Coalition Government's "Big Society" agenda committed to a radical devolution of power to municipalities, local delivery agents, and communities. A *Localism Act* has begun the shift away from a highly prescriptive legislative relationship, and provided more local control over governance, planning, and some aspects of local finances. Recognition of the critical economic role of cities has been central to efforts to empower metropolitan areas. The establishment of the Greater London Authority in 2000, an upper-tier government for metropolitan London with a high-profile directly elected mayor and assembly, has provided the capital region with greater capacity to plan for growth and economic development and coordinate regional services such as transportation and public safety. The national government is negotiating customized "City Deals" with other large metropolitan areas such as Manchester and Liverpool, one-off negotiations to devolve authorities, improve regional governance and coordination arrangements, and provide new financial and economic development tools to enable UK cities to develop growth and investment strategies that reflect local needs and conditions.

The UK Government's approach was articulated in a recent report, co-authored by Cities Minister Greg Clark, which describes a changing role for national and state-level governments whereby:

They seek to provide the national platform for city development, in the form of infrastructure investment, macro-economic policy, tax and regulatory reform, while devolving power and responsibility to cities themselves, allowing them to develop their own bespoke solutions to the problems they face (Clark and Clark 2014, 8).

This vision embraces the principles of “system stewardship,” as central governments move away from traditional command-and-control models that focus on stand-alone initiatives in siloed policy areas, towards a role as *stewards* responsible for steering the system towards desired outcomes. This requires decentralization of responsibilities for policy development and delivery, with adequate oversight and supports to provide local actors with greater freedom to adapt and respond to their unique environments (Hallsworth 2011).

The transformation of intergovernmental relationships is seldom easy. A landmark report prepared in 2010 by United Cities and Local Government, a global network of big cities, noted that while important intergovernmental shifts are occurring, the road has been rough and profound challenges remain (United Cities and Local Governments 2010). While the Canadian model of fiscal federalism is distinctive and advanced in some respects, provincial-municipal relations in Ontario suffer from many of the same difficulties as in other countries. The OECD has identified four primary gaps in the intergovernmental architecture of member states: discrepancies between fiscal capacity and service responsibility; informational asymmetries in the design, implementation, and delivery of services; capacity shortfalls where skills or resources are not adequate to fulfill responsibilities; and administrative challenges where jurisdictional boundaries do not align with economic or service delivery realities (OECD 2009).

Regional governance and local coordination

The misalignment of municipal boundaries with functional economic areas, service delivery responsibilities, or funding arrangements remains particularly problematic in Ontario. The metropolitan governance structures recommended by the commissions and task forces of the 1990s have proven as elusive here as they have elsewhere around the world (Slack and Bird 2013). But the need for regional governance and local cooperation to address the challenges of coordinating services and making investments across large metropolitan regions such as the Greater Toronto Area has continued to grow. Many of the most pressing areas of shared provincial-municipal responsibility cross local boundaries, particularly transportation, land use planning, and economic development.

The Province has taken some steps to develop regional strategies, through the creation of Metrolinx, regional growth plans, and regionally targeted economic development funds. Recent experiences with transit planning in the Greater Toronto and Hamilton Area, however, highlight the tension between Crown agencies and regional planning with the interests of a fragmented group of municipalities. Other provincially legislated governance mechanisms, such as conservation authorities, have a mandate to act as regional decision-making bodies but are often focused on a single set of functions and are seen to have weak local political accountability. Large, urbanized “separated” cities such as London and Guelph, which sit within and are growing into surrounding rural counties, face similar regional planning and service coordination challenges.¹⁶ In some sectors,

16. See Spicer 2013 for more details.

such as economic development, the lack of coordination extends far beyond municipalities (See Case Study 1).

Case Study 1: Economic Development – Too many cooks in the kitchen

Economic development activities are notoriously fragmented. Federal entities like the Development Agency for Southern Ontario, the provincial Ministries of Economic Development and Research and Innovation, a multitude of municipalities across the province, and organizations like the Greater Toronto Marketing Alliance all play overlapping roles. Consequently, there is duplication of effort in functions including promotion and trade missions to attract foreign investment, the proffering of grants or low-cost financing to lure companies, and the provision of services and supports to local businesses.

Studies have suggested that this fragmentation and duplication results in significant inefficiencies, the crowding out of private investment, and the reduced effectiveness of provincial efforts to increase provincial “brand recognition” for potential foreign investors. Wolfe and Nelles make the case succinctly: “Achieving more effective policy alignment requires a greater degree of coordination across various levels of government, at both jurisdictional and spatial scales, as well as among their respective economic development agencies.”

Sources: Zizys 2012; Wolfe and Nelles 2009.

Applying a broader policy lens to regional challenges is important, but there are few mechanisms to improve coordination among municipal governments within metropolitan regions. New governance mechanisms are most needed in the Greater Toronto Area. Formal coordination mechanisms should also be considered for other regions, notably for cities and separated counties. Municipalities could also take the lead by creating voluntary cooperation mechanisms, as is common in many other jurisdictions (Slack and Bird 2013). Existing forums, such as Association of Municipalities of Ontario (AMO), the Large Urban Mayors’ Caucus (LUMCO), and the Mayors and Regional Chairs of Ontario (MARCO), offer venues to increase municipal coordination. Governments can also partner with non-profit, civic, or business-led organizations such as the Toronto Region Board of Trade and the Civic Action Alliance to increase awareness of regional issues and foster collaboration.

Rural municipalities generally function best when they are not required to shoulder wider, non-property-related responsibilities, leaving those functions to county and regional governments. In Northern Ontario, for instance, the absence of a county system makes the policy-making environment for human services and economic development cumbersome and often ineffective, and predictably too focused on cost and parochial considerations. Strengthening county governments, and perhaps extending county government structures to Northern Ontario, or expanding the scope, representativeness, and accountability of District Social

Services Administration Boards (DSSABs) would provide more financial and structural “critical mass” in dealing with the issues facing the rural economy and northern communities.

For smaller communities, shared service agreements, joint purchasing arrangements, voluntary cooperation, or amalgamations could also offer potential to improve service efficiency and provide savings under certain circumstances. Research suggests that the potential for economies of scale in service delivery through amalgamations are often exaggerated (Found 2012). Yet, the reforms of the late 1990s prompted many inter-municipal agreements in provincially mandated human and protection services. Today, more than 90 percent of Ontario local governments report having some form of shared services, and a number of regional joint purchasing groups have been formed to minimize procurement costs. Still, there remains much potential for voluntary cooperation in other areas (Spicer 2013). For smaller municipalities, planning, landfill operations, and libraries could be good candidates for shared service arrangements (KPMG 2013).¹⁷

Different treatment for cities and small, rural communities

The principle of equal treatment of all municipal bodies is a source of growing governance tension between Ontario’s cities and metropolitan regions and its small and rural communities. Ontario’s 444 municipalities range from the 2.8 million residents of Toronto to the two permanent residents in the Township of Cockburn Island. Graham and Phillips argued more than a decade ago that Ontario’s “large urban centres can no longer be accommodated in the same legislative and policy regimes as their small-town and rural counterparts” (1998, 205). Yet, general municipal legislation and provincial oversight continues to maintain a bias towards uniformity of treatment. The notion that all Ontario municipal corporations are equal has been formally rejected only by the City of Toronto.

It has been politically difficult to provide cities and city-regions with additional resources, in spite of the argument that the broader scope of responsibilities and urban servicing needs creates an additional administrative and financial burden (Mintz and Roberts 2006). The tendency to equal treatment also ignores the fact that local authorities in cities and city-regions manage local administrations that are larger than some provincial governments and have in place robust financial controls and accountability regimes, as well as the policy-making expertise to develop programs in complex areas. In short, they have far greater capacity for autonomy and innovation, and this capacity should be recognized by provincial governments.

17. Geography is an important factor in cooperation. Cost-sharing arrangements are more common in larger, southern Ontario municipalities, as isolated northern and rural communities are less able to share infrastructure-intensive services like fire, roads, and water.

As Tindal and Tindal (2013) have noted, asymmetrical federal-provincial arrangements reflect the unique sizes, needs, and capacities of provinces. Why not do the same for municipalities? The *City of Toronto Act* represented a modest step in this direction. But big cities such as Ottawa, London, Mississauga, and Hamilton continue to operate within the one-size-fits-all *Municipal Act* and all-encompassing provincial policies, despite having far more in common with Toronto than with the hundreds of small municipalities in Ontario. There are signs that this tension is getting greater recognition. The Provincial-Municipal Fiscal and Service Delivery Review, 2008, acknowledged that, given their diverse needs and capacities, municipalities are best served if they are treated differently based on functions, size, resources, nature, and geography. The 2013 Ontario Budget reinforces the point that needs differ between urban centres and regions such as the Greater Toronto Area and northern and rural municipalities (Ontario Ministry of Finance 2013).

3.3 *The provincial-municipal relationship: A tangled web*

The Province has a role in virtually every area of municipal responsibility. This includes setting out legal authorities through legislation, establishing policy direction and regulatory frameworks, setting local mandates and service standards, providing funding through transfers or other cost-sharing arrangements, and the interactions in delivering services that are a shared responsibility. There are, for instance, more than 70 pieces of provincial legislation that have implications for the municipal sector. The relationship is further complicated by federal jurisdiction in many areas, as well as by third parties that play key roles, including entities such as school boards, hospitals, or hydro agencies, private or non-profit service delivery agents, and an array of municipal-sector associations (see Figure 3).

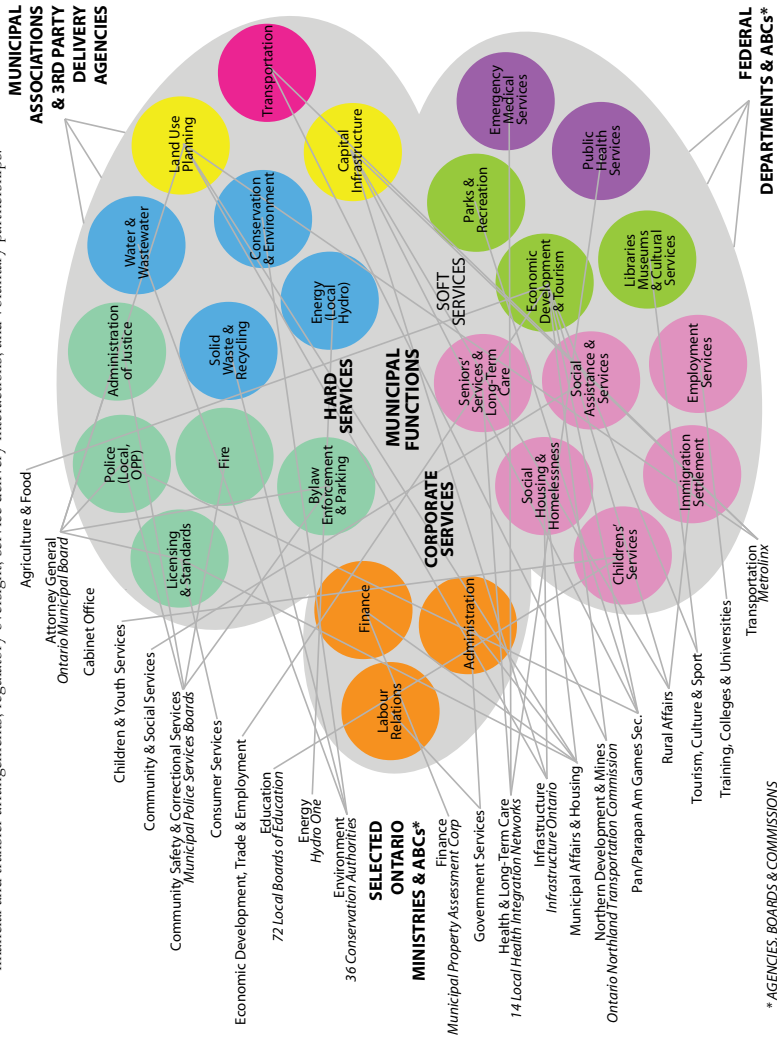
The complex universe of provincial-municipal relations

Municipal responsibilities can broadly be divided into three areas: “soft” services, “hard” services, and corporate services. The first area includes a range of “human services,” such as social assistance administration and disability, employment and training supports, child care, social housing, immigration and settlement, public health, long-term care and emergency medical services, as well as parks and recreation, arts and culture, and economic development. Provincial policy oversight, joint funding, or shared delivery responsibilities are spread across a range of ministries.¹⁸ For-profit and not-for-profit third-party agents also deliver some of these services. Since the late 1990s, municipal planning and delivery of many human services has been coordinated in some large and upper-tier municipalities through Consolidated Municipal Service Managers (CMSMs) and, in Northern Ontario, District Social Services Administration Boards (DSSABs).

18. These include Community and Social Services, Children and Youth Services, Training, Colleges and Universities, Health and Long-Term Care, and Education among others.

Figure 3: The Ontario Provincial-Municipal Universe

This representation shows just some of the actors in the universe. There are a vast number of relationships through legislation, financial and transfer arrangements, service delivery oversight, regulatory oversight, and voluntary partnerships.



The story is similar with “hard services,” which include property services, like land-use planning, infrastructure, transportation services, and local hydro distribution, waste management, water and wastewater, and, depending on one’s definition, protection to people and property, such as fire, police and courts, licensing, building codes and by-law enforcement (e.g., parking and business regulation). Again, provincial ministries and a range of other actors oversee, regulate, fund, and interact in these policy areas.

Corporate services include financial administration, human resources, information technology, intergovernmental affairs, and legal counsel. Property tax rate setting, administration, and collection are undertaken locally, while policy and assessment are managed through the Ministry of Finance and the Municipal Property Assessment Corporation (MPAC). The Ministry of Municipal Affairs and Housing (MMAH) is responsible for development charges and local land-use planning policies, with regional planning resting with the Ontario Growth Secretariat housed in the Ministry of Infrastructure. Certain intergovernmental initiatives – from the 2015 Pan Am Games and Toronto’s waterfront development to Ring of Fire mining investments in Northern Ontario – require significant cooperation between provincial and municipal governments, as well as the Government of Canada and a number of Crown agencies.

Many provincial ministries have unique interactions with the municipal sector and with specific municipalities. The Government of Ontario has made recent efforts to coordinate these interactions internally through the MMAH.¹⁹ Coordination challenges are increased, however, by the range of other provincial agencies and entities with which municipalities interact, such as Infrastructure Ontario (IO) for municipal borrowing and public-private partnerships, the Ontario Municipal Board (OMB) for land use planning appeals, the Technical Safety Standards Association (TSSA) for regulation and enforcement of fuels and boilers among other things, conservation authorities for the preservation of regional water, land and natural habitats, and local health integration networks (LHINs) for the coordination of regional health services. Federal departments, agencies, and commissions also play a role in municipal affairs, adding further complexity.

There are also a large number of municipal sector organizations. The Association of Municipalities of Ontario (AMO) engages the province on behalf of the majority of local governments, with the exception of the City of Toronto. Other intermediaries include the Federation of Canadian Municipalities (FCM), which represents local governments on pan-Canadian issues. On a less formal basis,

19. MMAH’s Municipal Services Division also supports local governments through regional offices across the province. Their programs and services, focusing on administration, land use planning, housing, economic development, and disaster relief, provide important capacity for smaller communities.

working groups, intergovernmental tables, advisory groups, and task forces may be convened by provincial ministries or by municipal or professional associations.²⁰

Realigning and integrating services

In the early 1990s, the Hopcroft Report recommended a strict division of responsibilities between governments. The Committee put forward a series of principles, notably that municipalities should have policy, delivery, and funding responsibilities for services deemed local in nature, whereas the Province should take charge where there are significant spillovers across municipal boundaries or redistributive impacts (Hopcroft 1991).²¹ More recently, that thinking has changed. The Report of the Provincial-Municipal Fiscal and Service Delivery Review, noting the highly intertwined nature of the provincial-municipal relationship, stated that “simplifying and better managing roles and responsibilities within a shared accountability framework would place more emphasis on achieving better outcomes for people in Ontario rather than on process” (2008, 11).

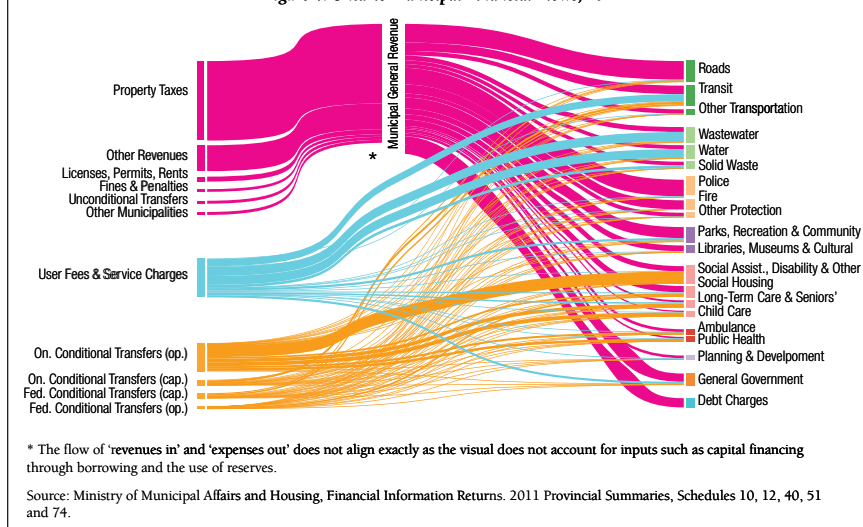
Today, a strict division of responsibilities may not be achievable or even desirable; but clearer and more cooperative intergovernmental arrangements could increase accountability, reduce costs, and improve outcomes. Researchers at the Mowat Centre, a think tank focused on intergovernmental arrangements, propose some basic principles for the alignment of roles and responsibilities: they should be assigned based on core competencies, opportunities to increase efficiency and reduce transaction costs, and the ability to enhance accountability so citizens understand which level of government is responsible for what (Mendelsohn, Hjartarson, and Pierce 2010). Another key principle is that fiscal capacities must be realigned alongside service responsibilities.

Yet, funding arrangements are extremely complex (see Figure 4) and there remain many policy areas where tangled responsibilities and a lack of integration of provincial and municipal services are creating higher costs, duplication of efforts,

20. The lengthy list of municipal associations includes the Federation of Northern Ontario Municipalities, the Rural Ontario Municipal Association (ROMA), the Ontario Good Roads Association (OGRA), the Counties, Regions and Single-Tier Municipalities Association (CRST), and regional/political agglomerations, like the Eastern Ontario Warden’s Caucus, Large-Urban Mayors Caucus of Ontario (LUMCO), Northwestern Ontario Municipal Association (NOMA), etc. Municipal professional associations also have a voice within the Ontario Government bureaucracy, including the Ontario Municipal Administrators Association (OMAA), the Association of Municipal Managers Clerks and Treasurers (AMCTO), the Municipal Finance Officers Association (MFOA), the Ontario Municipal Social Services Association (OMSSA), and a number of others representing professional groups (police, fire, housing, building officials, land-use planning, engineering, transit, economic development, recreation, etc.).

21. The Who Does What Panel’s recommendations were guided by similar principles. Where possible, the government responsible for spending and service delivery should be responsible for funding, with responsibilities matched by adequate financial resources to pay for them (Who Does What Panel 1996).

Figure 4: Ontario Municipal Financial Flows, 2011



and greater difficulties for citizens in accessing the services. For example, the Province delivers 45 different income-tested benefit programs for low-income individuals and households, which provide benefits through the tax system, as income support transfers, or through in-kind benefits. These programs – ranging from the Ontario Sales Tax Credit and social assistance to rent-geared-to-income housing supports and dental benefits – interact closely with each other, and with other programs and services at the municipal and federal levels. With multiple delivery agents across many ministries and among third-party providers, there is duplication, a lack of coordination, and differing application requirements and eligibility criteria, all of which create service gaps, inequities, and difficulties for citizens in navigating the system.

The policy area where the lack of provincial-municipal integration and alignment is most evident is human services (see Case Study 2). The provincial Social Assistance Review Commission's report, released in 2012, proposed a dramatic transformation of human services in the province that focused on realigning and integrating social assistance and labour market programs (Lankin and Sheikh 2012). A ready-made example of integrated service arrangements in Ontario is the "Service System Manager" model, which brings together programs ranging from child-care, income support, and Employment Ontario programming, through to supportive housing, and long-term care.²² There are two central

22. The Ontario Municipal Social Services Association (OMSSA) and the Northern Ontario Service Deliverers' Association (NOSDA) have become pioneering advocates of the concept of integrated "Service System Manager."

Case Study 2: Human Services: How to Improve Outcomes while Reducing Costs

“Human services” includes everything from child care and old age homes to public housing and low-income supports to welfare and job-seeker supports. Their complexity results not just from the interactions between these services, but from the fact that responsibility for funding and administration is shared by federal, provincial, and municipal governments, with delivery through a number of ministries, agencies, and third-party delivery agents.

At the heart of the system is the social assistance program, which comprises the Ontario Works (OW) welfare program and the more generous Ontario Disability Support Program (ODSP) for clients who face barriers to employment. In 2011-12, provincial and local expenditures on the two programs was \$8.3 billion – more than provincial expenditures on post-secondary education and training.

In addition to concerns about the inadequacy of OW benefit levels for low-income Ontarians, the social assistance system is plagued by:

- fragmentation of responsibilities, with municipalities administering OW while the Province administers ODSP and is assuming the full costs of benefits for both programs;
- inconsistent benefit levels, eligibility requirements, and system access points for clients;
- a lack of integration across provincial and municipal social assistance and labour market policies, and with federal Employment Insurance (EI); and
- rising costs, largely driven by the recent growth in the ODSP caseload, which is now larger than OW (300,000 recipients versus 265,000 in 2012).

Following the release of the report by the Social Assistance Review Commission, the 2013 Ontario Budget modestly increased benefit rates and reduced earnings and asset limits that were acting as a barrier to employment.

But the real transformative opportunities, as the Commission identified, lie in realigning and integrating administrative responsibilities for OW, ODSP, and employment support programs to the municipal level. These reforms could allow for better policy coordination between governments and across programs, ideally including federal Employment Insurance. Clients could receive supports through a single social assistance benefit, accessed through one entry point, supported by a case manager who could access the range of locally delivered human services.

Sources: Lankin and Sheikh 2012; Ontario Ministry of Finance 2013.

objectives. For the client, integrated, customized services allow for easier access and better accommodation of individual needs;²³ for the municipality, an integrated approach allows public and not-for-profit or private delivery agents to provide a “network” of services, more efficiently delivering services to client populations while ensuring that standards for efficiency, equity, and service quality are met.²⁴

One of the largest local service integration projects to date in Canada is under way in Peel Region. This regional municipality is in the process of integrating its administration and case management functions for social assistance, housing, and child care services. The reforms offer administrative efficiencies and cost savings, but, perhaps more importantly, the capacity to refocus program spending to tackle complex social policy challenges and to better serve client groups. Among the most basic lessons from Peel’s integration initiative is that, “for provinces and municipalities alike, successfully integrating human services requires careful planning and a sustained commitment to change” (Gold and Hjartarson 2012, 39). A clear lesson is that for complex, systemic reforms such as the Social Assistance Review Commission proposals, a unilateral provincial approach would not work. Instead, a cooperative process is needed that allows for assessment of the impacts on client groups, carefully planned implementation, and the realignment of responsibilities and costs across governments.

Another area where better alignment could support shared provincial-municipal objectives is in relations with the federal government. In areas ranging from infrastructure and housing to employment supports, federal policy has often featured unilateral shifts in direction, or favoured episodic, unpredictable, and “capped” funding agreements, which limit the capacity for provincial and municipal governments to plan effectively.²⁵ The Federation of Canadian Municipalities (FCM), the primary municipal conduit to the federal government, is a strong and effective voice but represents all Canadian municipalities. At the same time, Ontario’s intergovernmental agenda with the Government of Canada has tended not to focus on municipal interests, beyond supporting efforts to secure new funding or resisting federal intervention in urban policy. More coordination in provincial and municipal advocacy and negotiations around federal infrastructure investment or programs such as employment insurance that link into provincial-municipal human services could produce better outcomes. There are some good

23. It is particularly important for client groups that access multiple services, such as the homeless and hard-to-house, the frail elderly, low-income single mothers, and urban Aboriginals.

24. Municipalities act as the “Consolidated Municipal Service Manager,” or CMSM.

25. Recent examples range from the Building Canada Fund and the Investment in Affordable Housing program to the proposed Canada Job Grant and unilateral reforms to Old Age Security and the Canada Health Transfer.

precedents, such as the tri-partite agreements on human services in Vancouver and Winnipeg.²⁶

Municipal compliance burdens and unfunded mandates

Ontario municipalities appear to be both responsible for funding a broader suite of services (see Table 4) and subject to more specific service mandates than local governments in other provinces (Slack, Kitchen, McMillan, and Vaillancourt 2007). “Mandated” services are generally those required by provincial laws or regulations and may be funded either through provincial transfers or local own-

Table 4: Municipal Expenditure Responsibilities across Canada, 2005

Responsibility* / Province & Territory	NL	PEI	NS	NB	QC	ON	MB	SK	AB	BC
General Government Services	X	X	X	X	X	X	X	X	X	X
Courts of Law					X					
Policing (incl. bylaw enforcement)		X	X	X	X	X	X	X	X	X
Fire Fighting	X	X	X	X	X	X	X	X	X	X
Regulatory Measures						X			X	
Roads and Streets	X	X	X	X	X	X	X	X	X	X
Public Transit			X		X	X	X	X	X	X
Hospital Care										X
Preventative Care						X				
Other Health Services						X	X		X	
Social Assistance						X			X	
Other Social Services			X		X	X			X	
Agriculture								X	X	
Tourism / Promotion & Trade / Industry				X	X	X				X
Water Purification and Supply	X	X	X	X	X	X	X	X	X	X
Sewage Collection and Disposal	X	X	X	X	X	X	X	X	X	X
Garbage / Waste Collection & Disposal	X	X	X	X	X	X	X	X	X	X
Recreation and Culture	X	X	X	X	X	X	X	X	X	X
Housing					X	X			X	
Regional Planning & Development	X	X	X	X	X	X	X	X	X	X

*An X denotes per capita expenditures larger than \$10

Source: Statistics Canada; compiled for Slack, Kitchen, McMillan and Vaillancourt 2007.

26. An assessment of the Vancouver Agreement, to address public health issues in the City’s Downtown Eastside, found that it “strengthened relationships, found collective solutions, and built a strong foundation for ongoing efforts and future collaborative initiatives” between the three orders of government (Western Economic Diversification Canada 2010, II).

source revenues. Municipalities also provide services that they may not be legally obligated to deliver.²⁷ Some municipal services are a legacy from expired provincial mandates or historic practices, such as trades licensing and regulation of certain types of local businesses (e.g., electricians, hairdressers).

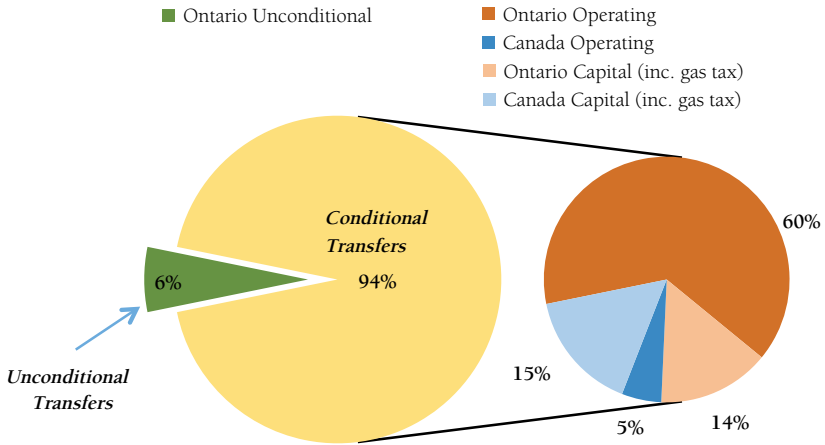
Provincially imposed standards exist for local services including social assistance, child care, long-term care, housing, water, solid waste disposal, building inspections, and fire protection. For instance, wastewater policies address everything from requirements to separate new stormwater management systems from sewage infrastructure, to public education regarding the disposal of swimming pool water. These standards can impose constraints on local governments in terms of how they provide and fund these services and the scope to innovate or reform delivery methods. Many standards are necessary and beneficial because they maintain public health and safety and represent reasonable checks on local autonomy. But many others are not. Is there really a Provincial interest in the wording of municipal public notices, the physical design of municipal child care centres, or restricting public access to municipal property assessment data?

One frequent consequence of mandated standards is unfunded mandates, where mandated services and standards are not accompanied by adequate provincial funding or, in some cases, by any funding. For example, new standards for water treatment and supply operations following the Walkerton Commission of Inquiry into water contamination and drinking water safety resulted in greater demands on municipal water treatment staff and higher capital costs, which have in turn created fiscal pressures for municipal governments (Slack, Kitchen, McMillan, and Vaillancourt 2007). As expressed by the City of Ottawa: “While the Province establishes the service standards and policies for [many] programs, municipalities have limited discretion over the level of service provided, or the level of funding necessary to deliver these programs” (2013).

Municipalities are also subject to a wide range of provincial oversight provisions and reporting requirements. This includes everything from standardized reporting of municipal finance and service level performance data, to compliance reporting for transfer payments such as the gas tax, to program audits for provincially-mandated programs. Anecdotally, one local official has estimated that his municipality is responsible for in excess of 250 separate reports annually. The weight of these accountability rules and reporting requirements imposes a significant administrative burden on local governments. The Government of Ontario has an “Open for Business” initiative that aims to reduce the burden of provincial policies and regulations on the private sector. Perhaps a similar initiative should be put in place for the municipal sector, cataloguing the regulations,

27. Anecdotal evidence suggests that provincial or municipal governments often are not certain which services are mandated and which are discretionary. This suggests that the distinction between mandatory and discretionary services might not be overly important. While the Province may mandate and set the terms for certain services, municipalities will still deliver others if they are demanded by their residents (Slack, Kitchen, McMillan, and Vaillancourt 2007).

Figure 5: Transfers to Ontario Municipalities, 2011



Source: Ontario Ministry of Municipal Affairs and Housing, Financial Information Returns. Provincial summary 2011. Schedule 10 - Consolidated Statement of Operations: Revenues.

standards, and reporting requirements municipalities must comply with, assessing their costs and benefits, and reducing unfunded mandates.

Conditional and matching transfers

While transfers are an important element in municipal finances, they can have a corrosive impact on fiscal management and accountability. They represent more than 20 percent of municipal government revenues in Ontario and a far higher share in some municipalities, as with many recipients of the Ontario Municipal Partnership Fund equalization transfer. A large share of provincial transfers cover the costs of benefit programs administered locally, with social assistance representing over 40 percent of operating transfers (Ontario Ministry of Municipal Affairs and Housing 2013a). Capital transfers have played a critical role in funding infrastructure investments.

The vast majority of provincial transfers are conditional. Despite a decline in the share of municipal funding through conditional grants since Local Services Realignment in the 1990s, they represented 94 percent of transfers to Ontario municipalities in 2011 (see Figure 5). Generally, conditional grants require municipalities to spend according to the rules established by the donor government. Matching transfers – conditional grants provided only if matched by the recipient government – create further distortions by encouraging municipalities to spend in areas where they can receive matching funding at the expense of other priorities. Federal transfers, which tend to be earmarked for

capital investments, often take the form of conditional, matching transfers (Slack 2010).

Public economists describe a “Wicksellian connection” between government expenditure and revenue decisions, in which a tighter link between those who benefit from services and those who pay for them should result in more efficient government and greater accountability.²⁸ In practice, the negative side-effects of transfer arrangements can include unpredictability as senior orders of government can arbitrarily change policies, reduced incentives for municipalities to properly price local services, and blurred political accountability for the public because the government delivering the service is not raising the revenues to fund it (Slack 2010).²⁹ The capital transfer system in particular has been characterized by *ad hoc*, short-term, application-based funding programs often lacking clear criteria, which limit local flexibility, discourage long-term fiscal planning, and undermine the objective of improving municipal asset management.

The Mowat Centre has advocated the elimination of conditional grants from Canada’s system of fiscal federalism, arguing that service standards are not always necessary to ensure high-quality programs, agreeing on standards can be difficult, and unconditional grants allow recipient governments more flexibility in tailoring programs to local needs (Mendelsohn, Hjartarson, and Pierce 2010). As provincial-municipal fiscal arrangements in Ontario are quite varied, eliminating conditional transfers is not likely or even advisable under present conditions given their importance in funding many cost-shared services. Still, the impacts of transfers on local revenue predictability, financial flexibility, and accountability should be recognized as provincial-municipal arrangements evolve. Eliminating conditional grants in favour of unfettered “block” grants can, however, be politically challenging. These changes often adversely affect some interest-specific constituencies that will respond strongly and negatively, while marginally benefitting a less directly affected broader constituency.

Municipal innovation in modernizing policies and service models

Constraints on local flexibility are often barriers to the modernization of municipal policies and services, and to the ability to tailor them to local needs and conditions. Ontario has hundreds of public-sector service-delivery “laboratories” in its municipal sphere – many of them with the scale and appropriate conditions to try

28. In the early 20th century, Swedish economist Knut Wicksell proposed a local finance model whereby municipal governments would be responsible for an appropriate range of local services (that is, not redistributive), with sufficient autonomy and access to the resources to finance and deliver them to an acceptable level (Bird and Slack 2013).

29. Recent intergovernmental transit politics in the Greater Toronto and Hamilton Area show the disconnect between the responsibilities for planning, funding, and delivering local transit projects; local governments identify their investment priorities while other orders of government are expected to foot the bill.

new things that would be difficult to implement on a province-wide basis. Less prescriptive and more collaboratively developed, outcome-oriented provincial policies and regulations – coupled, of course, with appropriate oversight, accountability, and support mechanisms – could create the conditions for more local innovation. For instance, policy frameworks could set out objectives and targets, establish basic requirements for equity and comprehensiveness, and provide implementation supports for local administrators, while leaving broad discretion for program design. In other words, specify the “destination,” not the “route.”

There are recent examples of this type of enabling of local innovation. A change to provincial regulations has allowed municipalities to use Local Improvement Charges (LIC), a funding mechanism for residents to make home energy retrofits.³⁰ On a broader scale, the Provincial *Housing Services Act* and Long-Term Affordable Housing Strategy, introduced in 2011, aimed to increase the flexibility for municipal service managers and other local social housing operators, while simplifying the system for citizens (see Case Study 3). The new provincial funding formula for child care, developed with municipal feedback and through an intergovernmental working group, increases local flexibility by eliminating tightly prescribed funding categories and streamlining rules and reporting requirements (Ontario Ministry of Education 2012).

Alternative service delivery (ASD) models present options for modernizing and innovating in program delivery. As reform can be difficult in the public sector, the benefits of ASD – often presented solely in cost-reduction terms – can also include the opportunity to circumvent some traditional barriers to reforming antiquated service models such as bureaucratic inertia or lack of capacity, constraints in collective agreements, or tight budgetary conditions.³¹ Zussman (2010) notes that the objectives of ASD include not just increased cost-effectiveness, but also more responsive service delivery for citizens, changes to organizational structures and management practices that can encourage better performance, and the shifting of authority closer to the point of delivery. Of course,

30. LICs allow municipalities to provide loans to homeowners to improve the efficiency of their residences with repayment applied to property taxes. Importantly, LICs tie the cost of the improvement to the property itself rather than the homeowners, who might not otherwise have made the investment for fear that they might not stay in the home long enough to see the returns. The City of Toronto is moving forward with a pilot program for single-family homes and multi-unit residential buildings, and other cities including Guelph, London, and Hamilton are part of the Clean Air Partnership that is developing an LIC model through a collaborative process with the Province (City of Toronto 2013b).

31. Barriers can include: successor rights legislation that preclude alternative service delivery models or partnerships with third-party delivery agents; the significant up-front costs of service modernization; or a hesitance on the part of governments to part with certain functions, even if they are essentially commercial and could be more suitably delivered under private market conditions (such as electricity utilities or public golf courses).

Case Study 3: Social Housing – A Policy Field Ripe for Local Innovation

Social housing provides subsidized rental units for low-income tenants. There are 270,000 social housing units in Ontario, representing about 5 percent of the province's housing stock. Stagnating incomes and a booming real estate market have created significant affordability challenges, and more than 150,000 households are on social housing waiting lists across Ontario.

Much of Ontario's social housing stock, largely built during the postwar era, is in need of renewal. Estimates suggest that 70 percent of the units have capital reserve shortfalls, with a total liability of more than \$1.2 billion. Municipalities and local housing providers are financially and operationally squeezed by provincial rules that constrain their ability to manage their subsidized units and rent levels. The result has often been the deferral of repairs or investments in energy or mechanical systems that could reduce operating costs.

During the 1990s, the federal government withdrew funding for affordable rental development and transferred administration to the provinces. In turn, the Government of Ontario devolved responsibility for social housing to municipalities in 2001. More recently, the new *Housing Services Act* (HSA) and other reforms signalled a more limited direct provincial role, with focus shifting to increasing flexibility for social housing providers and improving their capital asset management. Yet, despite the renewal of the Investment in Affordable Housing program, the major federal-provincial funding vehicle, tight fiscal conditions will limit the prospects of transformative provincial uploads or funding commitments.

Instead, efforts appear to be shifting towards creating the conditions for more local innovation in managing social housing portfolios and finding new financial models to grow the affordable housing stock. Provincial-municipal collaboration has led to the Toronto Regent Park revitalization public-private partnership, and to significant savings in Ottawa and Toronto through mortgage refinancing of social housing properties. There are other opportunities for collaboration around service standards and asset management for strained local service managers, energy-saving retrofits, and alternative financing models with the private and non-profit development and finance communities.

Source: Cote and Tam 2013.

the form ASD can take should be contingent on local context and the nature of the service.³²

In waste management, for example, the evidence suggests that benefits are less about public versus private collection than about government creating a competitive marketplace for service provision. In the United Kingdom, when a compulsory system of competitive tendering was introduced, municipal costs fell significantly with no impact on service quality – including where provision remained with public agencies (Massarutto 2007). Early indications about tendering for garbage collection in parts of Toronto have also been positive.³³

Governments have been experimenting with pay-for-performance models or incentive payments. These models encourage innovation by forcing established service providers to meet performance goals or face the loss of eligible financing. For example, following a model used in parts of Europe, the Province or one of its agencies could offer grants to public or private agencies to provide certain services (e.g., transit or trunk water distribution), conditional on meeting productivity or performance objectives. Along similar lines, governments in the U.K. and the U.S. have been piloting social impact bonds for programs to reduce criminal reoffending, with payment linked to achieving performance targets.³⁴

In certain cases, it is debatable whether government needs to provide the service directly, or at all. Some utility functions, for example, are “public” (sanitary sewage) while others (natural gas distribution) are not. Recreation services such as hockey, swimming, and soccer are often municipal programs, while bowling, golf, and skiing are generally offered privately. When considering ASD arrangements, the true test should be whether regulated market conditions can advance the public interest, ensuring good quality, operational efficiency, product innovation, equitable treatment, and reasonable cost to a full range of consumers.

Maturing local governance and public administration

The unique and evolving characteristics of municipal governance add a further layer of complexity to the management of provincial-municipal relations. The openness of the municipal system – or, the city hall “fishbowl” – can make intergovernmental planning or negotiations more difficult, and heighten the

32. Zussman identifies a spectrum of service delivery models: direct delivery; agencies; devolution; contracting from a private provider; partnership; franchising or licensing; and outright privatization. He notes that the international embrace of ASD has been driven by factors including new technologies, changing worker preferences and shifting public expectations of government, while conceding that ASD models can create challenges with complexity, fragmentation, and accountability (Zussman 2010).

33. In addition to the cost savings, the private contractor has been achieving performance targets while the number of public complaints has fallen below previous levels when city employees delivered the service (Dale 2012).

34. For an overview of social impact bonds, and the emerging realm of social finance, see Canadian Task Force on Social Finance, “Mobilizing Private Capital for Public Good: Measuring Progress During Year One,” December 2011, 7-8.

politicization of issues. Private organizations – and, to a lesser extent, parliamentary governments with Cabinet confidentiality and budget secrecy traditions – can quietly explore options to reduce costs and transform operating models. However, the transparency of municipal decision-making makes policy discussions a matter of public record well before any action can be taken or fully developed strategies crafted. The annual, media-focused municipal budget process also helps to explain the reluctance of municipal councils to demand productivity improvements, to raise taxes to keep pace with inflation, or set an “appropriate” level of taxation relative to other municipalities.

The effectiveness, transparency, and accountability of local governance have been prominent issues in provincial-municipal relations. In a system where council remains the supreme decision-making body, there can be uncertainty about the firmness of a municipal position, or about who speaks for a local government, where there is tension between the mayor’s position and that of other legislators. Recent scandals regarding the ethics and integrity of municipal politicians raised serious questions about local accountability mechanisms, the recourse local councils and the public have to deal with misconduct, and whether the Province should have a role in intervening. In this vein, the Ontario Ombudsman (2013), who has a mandate to oversee municipal compliance with open meeting rules, has been vocal in criticizing local governments for their lack of transparency and in seeking an expanded role in the municipal sector.

To address some of the perceived shortcomings in municipal governance, there continue to be calls for stronger mayors, political parties, and other trappings of parliamentary government.³⁵ This corresponds to the trend to wider, centralized authority in the offices of Prime Ministers and Premiers in other orders of government. In the non-partisan Ontario municipal world, however, it may not be good public policy. Strong mayor systems work well when fortune produces leaders like Michael Bloomberg. But more often, they tend to marginalize legislators and, in particular, professional civil service leadership. Again, history provides some important lessons. The failure of the “strong mayor” system was an important contributor to previous reforms of the municipal system in North America. The Council-Manager (“city manager”) civic reform movement, originating with Woodrow Wilson, and other similar reforms tried to distinguish between the political, policy-setting, and community-representative roles of elected executives and legislators, and the policy and budget development, program-design, implementation, and fiscal management roles of professional public servants.

The Canadian municipal model provides a better balance. A mayor’s position is first-among-equals within a legislative body, where the executive role of the mayor is not preeminent and should be shared with a professional management

35. Reforms to the *Ontario Municipal Act* and the *City of Toronto Act* did accord mayors and other heads of council with modest new designations and powers, though nothing approaching the sweeping executive authority of “strong mayors” in the United States.

executive who is responsible to the whole elected body, not just to the mayor. In corporate governance language, it parallels the difference between a Chair of the Board and the Chief Executive Officer (CEO). The mayor acts as chair of the board (or council), providing political direction, community leadership, and accountability; the City Manager acts as the Chief Executive Officer, accountable to the council for the financial and operational performance of the corporation. The 2001 *Municipal Act* went so far as to designate the mayor as the Chief Executive Officer of the municipal corporation, as well as being the head of council. Modern corporate governance recognizes these two roles as fundamentally different; urging a clear distinction between the position of Chair of the Board, and Chief Executive Officer. There is a strong argument that the same should apply to municipal government, where the mayor or head of council should be recognized as the political leader and the “chair” of the council, but the City Manager should be recognized as the CEO.

The growth in the size of municipalities and the scope of their responsibilities requires that municipal governance mature in lockstep. Achieving that goal should begin with a re-commitment to the importance of an impartial, ethical, and professional local public service. The municipal sector will continue to be subject to provincial oversight, reporting requirements and laws concerning everything from financial management to conflict of interest and local elections. But further provincial intervention in local governance and accountability should be limited to the extent possible. As democratically accountable governments in their own right, municipalities should be responsible for putting in place and enforcing appropriate provisions to ensure that local administration, function efficiently, transparently, and with appropriate respect for professional and managerial competence, and that elected officials and civil servants are held to high standards of ethical and professional conduct.

3.4 *Municipal fiscal health: Trouble on the horizon?*

On the surface, municipalities might appear to be on firmer fiscal footing than other orders of government, with balanced operating budgets, relatively modest levels of borrowing, low debt loads, and strong credit ratings. But there is great variation in the size, scope, and fiscal capacities of municipalities, as well as threats to local fiscal sustainability. Moreover, municipalities have struggled to contain compensation costs and lack flexibility in the choice of revenue-raising tools. The most significant risks relate to the deteriorating state of local infrastructure and the absence of sustainable means to finance capital investment. As Enid Slack has noted, “If municipal governments in Canada appear fiscally healthy because they have under-invested in services and infrastructure essential to their economic health (transportation, roads, sewers, recreational facilities, for example), the seeds of a serious future crisis may already be sown” (Slack 2006, 7).

Variability in the fiscal circumstances of Ontario municipalities

Fiscal health is a reflection of a municipality’s capacity to meet its expenditure needs with its revenue sources. Municipal finances in Ontario are generally not at

risk of fiscal crisis, but fiscal health varies across municipalities according to size and region, economic growth and prosperity, demographics and service demands. In short, while *vulnerability* to external forces is one issue, the *flexibility* and *sustainability* of local government finances should also be of concern.

Recent research by Slack, Tassonyi, and Grad (forthcoming) examined the relative fiscal health of the 30 largest municipalities in Ontario over the period from 2000 to 2011.³⁶ The study found that while Ontario's large municipalities have generally managed their finances conservatively, some cities are faring better than others. The growing GTA municipalities are faring the best. Oakville, Vaughan, and Mississauga ranked highest, given their growth in population, economic output, and property assessment. Older industrial cities (such as Niagara Falls and Windsor) and northern municipalities (Thunder Bay and Sault Ste. Marie) have a weaker capacity to raise taxes, greater dependence on provincial transfers, higher debt levels, more constraints in financing infrastructure, and greater expenditure needs driven by high demand for social services.

The variances are even more profound between large urban areas and small, rural, and northern communities. Siegel (2009) has described this as the challenge of the "Two Ontarios." With some exceptions, city-regions are addressing growth-related issues, whereas small towns, rural, and northern areas are facing demographic decline and sluggish economic growth that undermine the property tax assessment base needed to pay for local services. The North has the added disadvantage of harsher climate and geographic isolation.

The assessment of Ontario municipalities undertaken as part of the Fiscal and Service Delivery Review process also highlighted these difficulties. All single- and lower-tier municipalities were examined on the basis of a series of indicators: property taxes and assessment base, municipal costs, demographics, and economic and financial conditions.³⁷ Northern municipalities generally fared poorly. Social services costs are among the highest in the province, while assessment growth has been modest. These municipalities depend heavily on provincial support. The results for rural municipalities were mixed, though rural communities in the north also fared poorly. Overall, the analysis revealed a general association between growth in population and business activity with better fiscal health (Provincial-Municipal Fiscal and Service Delivery Review 2008).

Another study for the Eastern Ontario Wardens' Caucus, a body that represents 114 municipal governments, identified threats to the fiscal sustainability of its mostly rural members: a limited tax base to pay for local services, compounded by an aging population and elevated unemployment rates; limited financial flexibility, with reliance on the residential property tax, increasing

36. The study encompassed the 30 largest single-tier and lower-tier municipalities – ranging in population from Toronto at 2.8 million to Sault Ste Marie with 75,000 – as well as the six upper-tier regional governments.

37. Notably, the fiscal health indicators did not factor in infrastructure need, a significant gap.

debt, and declining working capital; limited resources to address infrastructure construction and maintenance needs, notably for roads and bridges; and limited potential for economic, population, or assessment growth. The report concluded that sustaining local services will become increasingly difficult in the years ahead (Eastern Ontario Wardens' Caucus 2012).

Fiscal instability and economic decline in some northern and rural communities can be self-reinforcing. Adequate public infrastructure and service levels are needed to support population growth, workforce development, and investment, yet are more difficult to sustain in communities that are less accessible, offer fewer amenities, and cannot achieve economies of scale. A recent report for the Federation of Canadian Municipalities noted that "for many municipal governments in rural areas, economic uncertainty impedes efforts to sustain financially viable rural communities" (Douglas 2006, 2). Adding to the structural financial burden many municipalities are facing are some previously hidden long-term obligations, ranging from unfunded sick-leave allowances payable to municipal employees to environmental liabilities for closed land-fill sites.

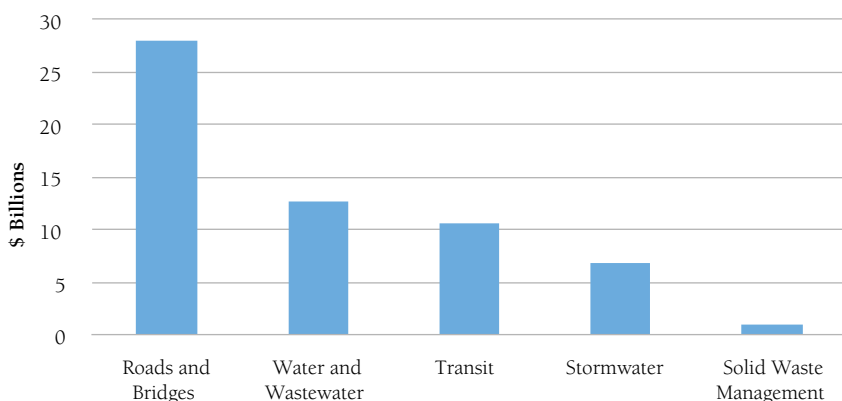
The municipal infrastructure deficit

Unquestionably the most important long-term liability is local infrastructure. In 2007, the Federation of Canadian Municipalities (FCM) reported that the national municipal infrastructure deficit stood at \$127 billion (Mirza 2007). In 2012, the first volume of FCM's Canadian infrastructure report card pegged the replacement costs for just four municipal asset categories – drinking-water, wastewater, storm water, and roads – at more than \$170 billion (Federation of Canadian Municipalities 2012). Estimates are similarly grim for Ontario, where approximately 40 percent of public infrastructure is owned by municipalities in the form of roads and bridges, water and wastewater facilities, transit systems, social housing, solid waste, and government buildings (Commission on the Reform of Ontario's Public Services 2012).

The Fiscal and Service Delivery Review process estimated the infrastructure deficit for Ontario municipalities at \$60 billion, nearly half of which was for roads and bridges (see Figure 6). The Association of Municipalities of Ontario (AMO) notes that these estimates do not include repair and replacement costs for social housing units, valued at an addition \$40 billion, or for municipal libraries and cultural assets related to tourism, or parks and recreation. AMO also points out that needs vary significantly among urban, suburban, and rural municipalities, and between growing regions and those where population and assessment levels are declining (Association of Municipalities of Ontario 2012).

Slack, Tassonyi, and Grad (forthcoming) compared the initial cost of capital assets in Ontario's cities with their current net book value to show the state of infrastructure in Ontario cities. The depreciation of the capital stock – or, the loss in value since the acquisition of the infrastructure – provides an indication of the cost to municipalities of renewing or replacing their infrastructure. They found that municipal capital assets valued at \$135 billion at the time of acquisition are

Figure 6: Ontario Municipal Infrastructure Investment Gap



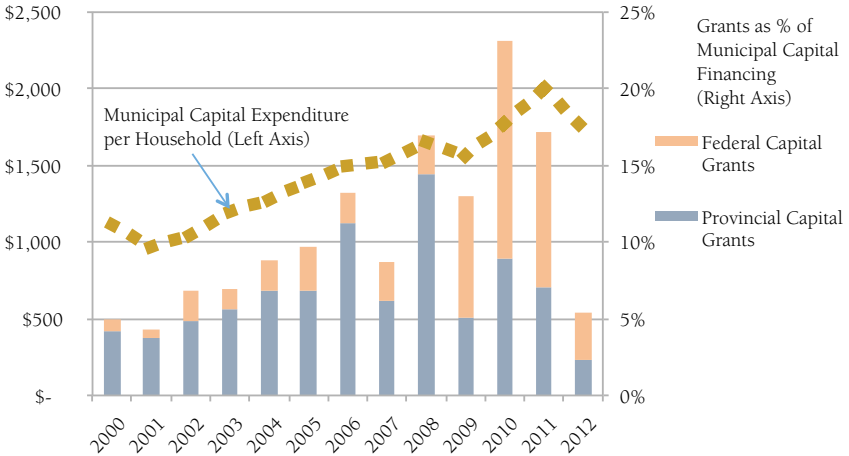
Source: Provincial-Municipal Fiscal and Service Delivery Review, 2008. Calculated using average annual estimates from 2006 to 2045.

now estimated to be worth \$93 billion, or 69 percent of their original cost. This suggests that, at minimum, the replacement cost across the 30 largest municipalities is \$42 billion. Newer, high-growth GTA communities like Vaughan, Markham, and Mississauga fared the best with assets valued at over 80 percent of their original cost; Toronto, Guelph, St. Catharines, and Thunder Bay have older assets that are worth less than 60 percent of the original value.

The Drummond Commission identified local infrastructure asset management as the major fiscal risk to the Province posed by the municipal sector. The report noted the challenge of underinvestment and proposed a heightened focus on asset management planning (Commission on the Reform of Ontario's Public Services 2012). The Government of Ontario has since launched an initiative to improve municipal long-term asset planning, which is focused on better cataloguing and assessing local assets and developing strategies to manage them over their lifecycles (Ontario Ministry of Infrastructure 2013).

Still, what is ultimately needed is more capital funding. On a per-household basis, annual capital expenditures by Ontario municipalities actually doubled during the past decade, owing in large part to a rising share of provincial and federal grants (see Figure 7). But these investments are not large enough to address the infrastructure shortfall caused by decades of underinvestment. Sustaining these investment levels will also be difficult. Moreover, as discussed earlier, the three-way matching transfer arrangements have limited local autonomy in prioritizing investment decisions, provide little transparency or predictability in funding formulas, and result in some highly politicized investment decisions. These arrangements might be unavoidable for large-scale projects that cannot be entirely

Figure 7: Ontario Municipal Capital Expenditure since 2000



Source: Ontario Ministry of Municipal Affairs and Housing, Financial Information Returns. Provincial Summary - 2000-2012 Multi-Year Review.

funded locally. Municipalities should, however, be responsible for funding most local infrastructure projects. Gas tax transfers now provide a more stable and flexible source of revenues for municipal projects, but other new regional or local revenue sources are needed.

Generating greater value from existing assets can also support infrastructure investment and renewal. In addition to capital assets, municipalities have other revenue-generating assets at their disposal, such as hydro distributors and parking authorities.³⁸ In 2011, Ontario municipalities reaped nearly \$700 million in dividends and interest income from “government business enterprises” (GBEs) (Ontario Ministry of Municipal Affairs and Housing 2013b). Still, certain assets could be better managed. Parking authorities in cities like Calgary and Los Angeles are using new smartphone and pay-by-licence-plate technologies, combined with better pricing policies, to enhance revenues and reduce road congestion. In the energy sector, there are 80 local electricity distribution companies (LDCs) in Ontario. While the largest utilities – Hydro One, Toronto Hydro, PowerStream, and Ottawa Hydro – serve hundreds of thousands of customers each, over a third of LDCs have fewer than 12,500 customers – often in regions with little population density. The results are higher operational, management, and borrowing costs; facilities duplication; and less efficient electricity systems that increase prices for

38. Municipalities also have significant real estate holdings and receive some revenues from provincial gaming facilities.

consumers and reduce municipal dividends. A provincial panel recently recommended options for voluntary consolidations of the 80 local distributors into eight to twelve larger regional distributors (Ontario Distribution Sector Review Panel 2012).³⁹

In keeping with the recent focus on more effective asset management, as recommended by the Drummond Commission and the Ministry of Infrastructure, there are significant opportunities for municipalities to “leverage” their considerable investment in municipal assets, both infrastructure and GBEs. Increasingly, there are discussions about an Ontario strategy following the Australian and U.K. models of “recycling” public assets: i.e., disposing of existing and legacy public assets in order to find the money to fund new or refurbished public assets, including public infrastructure. By “monetizing” existing assets, municipalities avoid recourse to the taxpayer or utility-ratepayer to build or rebuild public infrastructure assets, whether financed as direct capital expenditures or to service debenture debt. This approach also allows more tax revenues to be used to reduce debt or to deal with growing operating cost pressures. Unlike development charges, which are restricted to “new growth” infrastructure, asset-recycling proceeds can be used for any capital purpose, including debt-retirement, public-private partnership (P3) operating costs, or major maintenance costs (Fenn 2014).

Compensation pressures

Municipal staffing costs represent a large and growing portion of local budgets. Salaries, wages, and employee benefits represented 43 percent of municipal operating spending in 2011 – up from 37 percent in 2001. The largest service areas – police, fire, and transit – account for nearly 40 percent of these compensation costs (Ontario Ministry of Municipal Affairs and Housing 2013c). Most municipal workers are unionized, and the highly fragmented environment for local collective bargaining creates difficulties in containing costs. In 2012, municipal governments in Ontario ratified 166 collective agreements compared with only 15 for the federal and provincial governments combined.⁴⁰ Collective bargaining often hinges on assessing comparable settlements in neighbouring jurisdictions, and generous agreements in certain localities may act as precedents for others. The threat of strikes or job actions can exert further political pressure on local government employers to settle.

To reduce the fragmentation of local bargaining, the Drummond Commission recommended that the Province allow municipalities to voluntarily opt into

39. Given the market demand for stable, revenue-generating investments like utilities, equity sales or outright divestiture could also be explored. For a discussion of how hydro utilities could generate greater value, and the policy and regulatory changes that would be needed, see Toronto Mayor’s Fiscal Review Panel (2008).

40. This does not include broader public-sector agreements in industries such as health and social services (Ontario Ministry of Labour 2012).

centralized bargaining processes (Commission on the Reform of Ontario's Public Services 2012).⁴¹ Better benchmarking of settlements, local conditions, and fiscal capacity across municipalities could also allow for more consistency and less contentious negotiations. This could take the form of a less formalized system of information sharing and collaboration across municipalities and with labour representatives, potentially supported by AMO or another intermediary.

The Government of Ontario's collective bargaining framework can also bind municipalities. Interest arbitration is applied to essential services such as police, fire, and emergency medical services (land ambulance), which are not allowed to strike. As arbitration is the only way to settle unsuccessful contract negotiations, independent arbitrators have significant discretion in setting compensation terms and working conditions, with little practical recourse for local governments.⁴² Municipal leaders complain that arbitrators replicate agreements in different jurisdictions without considering the different fiscal or economic conditions between communities. Windsor Mayor Eddie Francis recently described the financial uncertainty his city faced as it awaited an arbitrated settlement for firefighters (Macdonald 2013). His anxieties were warranted: in October 2013, the arbitrator awarded the firefighters a 15 percent wage increase over five years with retroactive back-pay, while reducing the length of their work week from 48 to 42 hours (Association of Municipalities of Ontario 2013a).

Over the past decade, firefighter and municipal police base wages have grown at an average of 3.3 percent per year, compared with 2.7 percent for other unionized municipal employees and 2.2 percent for private-sector workers (Ontario Ministry of Labour 2013; see Figure 8). An arbitrator recently awarded City of Toronto firefighters a pay increase of more than 14 percent over five years – or 2.8 percent per year – in line with the agreement negotiated with police.⁴³ Facing awards that were well above recent wage settlements negotiated with other Toronto municipal workers, councillors complained that they are at the mercy of interest arbitrators and can do little to control the escalation in labour costs (Maloney 2013). In early 2013, municipal leaders petitioned the Province to reform the interest arbitration system by increasing the transparency of the process and requiring that arbitrators apply criteria in assessing local fiscal conditions (Association of Municipalities of Ontario 2013b).

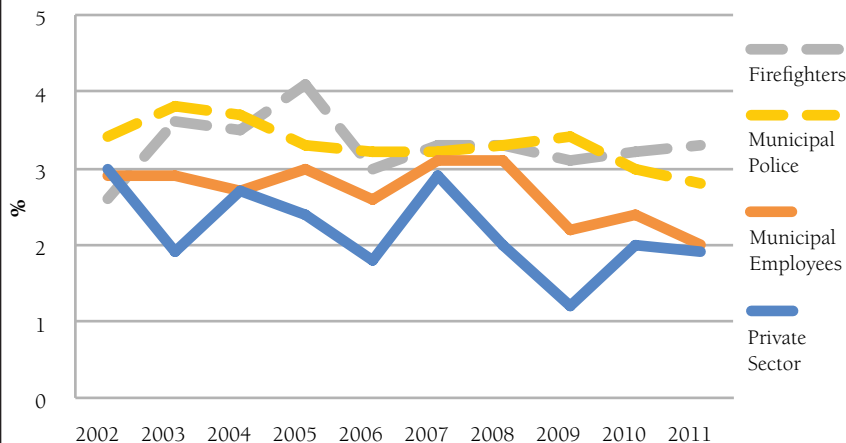
Pension and post-retirement benefits can also be a major financial liability. Municipalities are required by law to participate in the Ontario Municipal

41. A number of municipalities and police services boards have recently proposed to collaborate on collective bargaining.

42. It should also be noted that, in some cases, municipalities have bound their own hands, as with Toronto Mayor Rob Ford's petitioning of the Province to enact essential services legislation for transit workers to avert local strikes.

43. In smaller communities, provincial compensation awards to the Ontario Provincial Police, which polices most of non-metropolitan Ontario on a fee-for-service contract basis, has also added to municipal costs.

Figure 8: Average Annual Increase in Collective Agreement Base Wage Rates

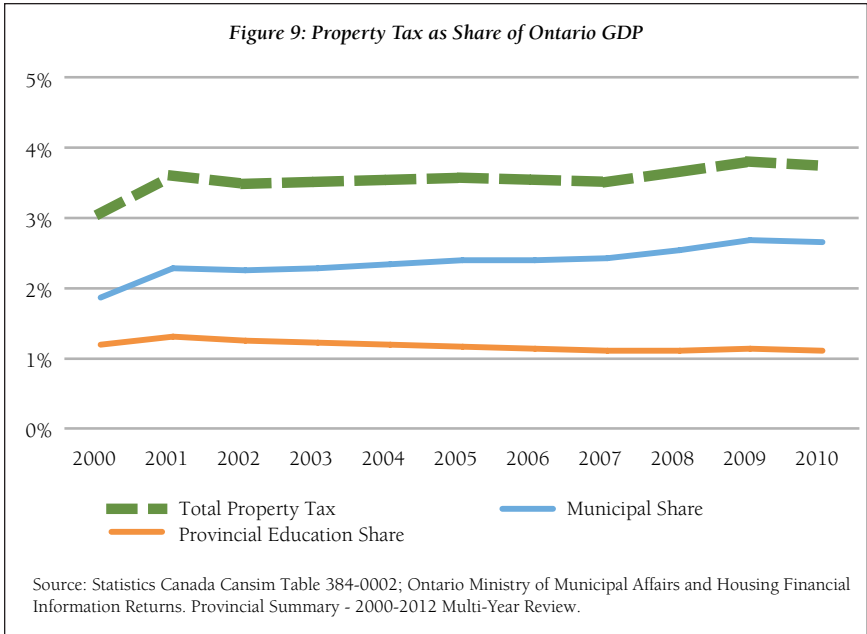


Source: Ontario Ministry of Labour, Collective Bargaining Information Services 2013

Employees Retirement System (OMERS), which offers a single defined-benefit pension plan for two classes of employees.⁴⁴ With \$65 billion in assets as part of a diversified portfolio of investments, OMERS represents nearly 1,000 employers including municipalities, police and fire departments, and transit and hydro agencies (Dean 2013). Although OMERS has a successful track record, it has faced investment challenges since the financial crisis and reported a large actuarial deficit in 2012. Contributions to the plan, shared equally by employees and employers, have been increased to unprecedented levels in an effort to return to fully funded status over time (OMERS 2013).

Unlike other employee benefit plans (such as health, dental, or sick-leave plans), municipalities cannot alter their pension plans or influence the funding allocations set by the OMERS plan's joint sponsors, which represent unions and employers. As a result, municipal governments have little influence over the growth in annual contributions, or the duration of high contribution rates. While post-employment liabilities do not appear to present the same threat as in the United States, they represented nearly 10 percent of the total long-term debt and liabilities of Ontario municipalities in 2012 (Ontario Ministry of Municipal Affairs and Housing 2013d). Transparent, periodic assessments of pension and retirement benefit obligations, conducted jointly by governments, unions, and plan sponsors, would help to inform municipal financial planning and collective bargaining negotiations.

44. Essentially, "uniformed" employees retiring at age 60, and all others eligible at age 65.



Flexibility and diversity in local revenue sources

The rising share of local expenditures funded through own-source revenues is a broadly positive trend, as it reduces local vulnerability to changes or reductions in provincial transfers. Yet with limited revenue-raising flexibility under provincial law, municipal governments continue to depend on one major tax to raise those revenues: the property tax. A few indicators suggest that municipalities could be limited in their capacity to continually rely on the property tax. Moreover, the major revenue source to fund new growth-related capital, development charges, may also be overused.

Since 2000, total property tax revenues in Ontario have risen as a share of provincial gross domestic product (GDP), largely driven by growth in municipal property tax revenues (see Figure 9). The total property tax burden – comprising both the municipal and provincial components – is higher in Ontario than in other large provinces on a per-capita basis and as a share of GDP (see Table 5), partly reflecting higher social service costs in Ontario. Commercial property tax rates have generally been in decline, but they remain significantly higher than residential rates and put a larger relative burden on businesses. In Toronto and Ottawa, for instance, commercial property tax rates are in excess of 2.5 times residential rates (Kitchen and Slack 2012).

Research by Bird, Slack, and Tassonyi (2012) suggests that the capacity of Greater Toronto Area municipalities to continue to increase the property tax could be limited. Taxation theory suggests that there is a revenue-maximizing tax

Table 5: Comparison of Property Taxes in Selected Provinces

Province	Per Capita			As % of Revenues (2008)		Total* as % of GDP (2008)
	Total* Per Capita	Municipal Per Capita	Municipal Share	All Revenues	Own Source Revenues	
Nova Scotia	\$1,140	\$919	81%	65%	74%	2.8%
Quebec	\$1,566	\$1,566	100%	65%	76%	3.7%
Ontario	\$1,785	\$1,251	72%	45%	62%	4.0%
Manitoba	\$1,156	\$787	68%	39%	53%	3.0%
Alberta	\$1,738	\$1,325	76%	44%	55%	2.0%
British Columbia	\$1,342	\$830	62%	52%	55%	3.2%

*Total includes the provincial / education property tax component.

Sources: Slack and Kitchen (2012) compiled from municipal statistics in each province; Statistics Canada Cansim Tables 385-0024 and 384-0038

rate, after which further increases will actually result in declining revenues. In essence, tax rates climb a “revenue hill” that generates increasingly marginal revenues as rates rise until reaching the peak, after which revenues begin to fall with rate increases. The authors’ study of GTA municipalities, using data from 1977 to 2005, found that while most of the 905 municipalities had room to increase business tax rates, many were near the top of the revenue hill for residential rates. Some, such as Oshawa and Mississauga, were already at or over the peak.

There has also been a growing reliance on revenues from property development in parts of the province. Since the early 1970s, most Ontario municipalities have paid for the capital costs of growth partly through development charges, a per-unit levy to cover the cost of municipal services to property and the neighbouring community in addition to the physical services developers install themselves. Development charge rates have increased by nearly 200 percent in the regional municipalities of Halton, Peel, York, and Durham since 2000 (Amborski 2011).⁴⁵ They have also gradually increased as a share of the cost of new housing (Ontario Ministry of Municipal Affairs and Housing 2013e). Charges are comparatively low in Toronto because the costs of capital for new development are lower than in surrounding cities, but they were increased significantly in 2013.⁴⁶

45. The combined upper- and lower-tier development charges range from about \$30,000 per single detached unit in Durham region to more than \$50,000 in Halton.

46. Development charges are much higher in the GTA than they are in other Canadian cities. They average just over \$20,000 in BC and less than \$10,000 in Edmonton and Calgary. In the U.S., “impact fees” average less than \$10,000 with the highest fees at just over \$20,000 in California.

Development charges support new infrastructure to service developments, but do not provide for operations, maintenance, and replacement of that infrastructure. The property tax on the assessed value of new development may not generate enough to cover these costs. For many municipalities with infrastructure built decades ago, the burden of replacing aging assets is now falling entirely on municipal taxpayers. This can be compounded by the averaged per-unit structure of most local development charges, which can create incentives for residential “sprawl” in lieu of denser land-use patterns that tend to be more efficient to service. Recent research has identified a series of policy options to encourage more location-efficient development, including development charging that better reflects spatial differences in the municipal costs of servicing new developments in order to set proper incentives for developers and homebuyers (Burda et al. 2012).⁴⁷

In addition to these trends, there are other compelling reasons for diversifying municipal revenue sources. The property tax is a good tax for local governments, but other taxes – such as sales taxes or others in fields not yet staked out by senior levels of government – are better linked to growth in the local economy.⁴⁸ They could also accommodate the reality that municipalities are no longer solely delivering services to property, and that many local services – particularly in metropolitan areas – are used by commuters and people who reside in neighbouring municipalities (Vander Ploeg 2012).

The Province has understandably been careful about granting access to new taxes. A number of factors should be considered, including the size and corporate sophistication of municipalities, local fiscal conditions, tax administration capacity, and efficiency considerations such as the risk of leakage across jurisdictional boundaries. In general, taxing powers make more sense for larger cities that deliver a broader range of human services, have greater administrative capacity, and could encourage implementation of taxes across metropolitan areas. Local governments should also be responsible for levying the taxes and setting the rates – even where other governments are responsible for administration.⁴⁹ As Mintz and Roberts have argued, “political and economic accountability is enhanced when governments must fund programs with the revenues they raise from taxes levied on their residents” (2006, 6). Arrangements

47. The design and siting of hospitals, educational campuses, and other public institutions, which are generally exempt from development charges, should also reflect “smart growth” principles.

48. One example is the local business value added tax (BVAT), a levy on business incomes (rather than on consumption, like the Harmonized Sales Tax) that is in use in a range of sub-national jurisdictions in the U.S., Europe, and Asia (see Bird forthcoming).

49. As major provincial taxes in Ontario are already administered by the Canada Revenue Agency, it makes sense to “piggyback” a local tax on the provincial rate to achieve efficiencies in administration, collection, and enforcement.

whereby other governments transfer revenues off their tax base, such as one cent of sales tax, would undermine this principle.⁵⁰

Beyond new taxes, there are other avenues for municipalities to enhance or diversify their revenues. One area is more robust collections and enforcement of municipal fines and charges.⁵¹ Another is municipal user charge policies for goods or services that provide a direct benefit to specific users, such as water rates, building permits, and taxi licences. Well-designed user fee policies can raise revenues while increasing service efficiency. A Québec task force described user charges that apply a full-cost pricing principle as “an indispensable means of sending the right signal to the user” (Gouvernement du Québec 2008). The limited evidence in Ontario suggests there is little consistency in local service pricing policies.⁵² Full-cost pricing principles could be applied to rate-based services such as water, parking, and hydro, and potentially to other user pay services such as transit and solid waste, if coupled with targeted supports for lower-income households to ensure equitable access. The Province could assist in establishing methodologies for calculating service costs that can inform local pricing policies.⁵³ As the Drummond Commission recommended, fees and charges should be

50. The latest example was in 2007, when Toronto Mayor David Miller launched the “One Cent Now” campaign with the mayors of other Canadian cities to secure a portion of the federal sales tax for municipal infrastructure.

51. There is an estimated \$1 billion in outstanding, uncollected Provincial Offences Act (POA) fines, largely for parking and other violations under the Highway Traffic Act. To recoup some of these revenues, Ottawa, Toronto, Mississauga, and some other municipalities are piloting a reciprocal arrangement where the unpaid POA fines of out-of-town drivers will be applied to property tax bills where they reside (Grewal 2013). Ontario’s 2012 Budget proposed to help municipalities collect these outstanding fines by withholding licence plate renewals or setting bad debts against CRA refunds for provincial taxes (Ontario Ministry of Finance 2012).

52. For instance, a study by BMA Management Consulting (2010) of water and sewer rate structures across 83 municipalities found that there was a great variety in the costs of the service, in the structure of rates, and in the extent to which user charges covered operating costs. In two-thirds of municipalities, rates were set in a uniform structure, with the price per unit of consumption remaining the same regardless of levels of consumption. A small group applied declining or inclining rate structures, with the former encouraging greater usage by reducing the charge as consumption increased, and the latter encouraging conservation. There was also great variance among municipalities in water and wastewater operating surpluses and deficits – a reflection of whether users are being charged for the full cost of the service.

53 The City of Toronto user fee policy is premised on the principle that “the pricing of user fees should generally take into consideration the full cost of the service (direct, indirect and cost of capital).” Yet, staff has noted that while full-cost pricing should be the standard, calculating the full-cost of delivering the service is often quite challenging, especially where capital and other indirect costs must be incorporated. The report also noted that, on the basis of access and equity considerations, some fees should be exempted from full-cost recovery (City of Toronto 2012).

indexed to the rate of inflation and updated periodically to reflect changes in the costs of services (Commission on the Reform of Ontario's Public Services 2012).

4. Towards a New Paradigm in Provincial-Municipal Relations

Ontario is approaching an important "inflection point" in provincial-municipal relations. Faced with economic, fiscal, and demographic challenges, all governments in Ontario will be strained in the coming years to transform the way in which policies are developed and public services delivered and funded. The good news is that periods of fiscal constraint and economic transition tend to produce innovation and public tolerance for change that can be difficult to marshal in better times. Around the globe, governments are finding themselves limited in their ability to improve public services with new spending and tax expenditures, so they are turning to other tools at their disposal – policy and regulation, service restructuring and devolution, governance reform, "leveraging" public assets – in search of creative solutions.

In Ontario, change will have to begin with the way the provincial and municipal governments understand their roles and the nature of their relationships. With little fiscal room to manoeuvre and an increasingly capable municipal sector, the Provincial role should begin to shift from one of "funder" to "enabler." The maxim should be to "spec' the destination, not the route." The Province should shift its attention to mandating the policy objectives, targets, and desired outcomes, while enabling municipal partners by providing flexibility in operational policy and program design to identify local solutions. This approach helped to spawn the Reinventing Government movement, led by the U.S. municipal reformers Osborne and Gaebler (1992). This enabling role will require working with municipal partners to create the right legal, regulatory, fiscal, and political conditions for increased municipal self-reliance, while ensuring adequate oversight and providing assistance in places where unique needs and conditions require it.

At the same time, municipalities should recognize that the onus will increasingly be on them to find solutions to their challenges, whether in modernizing services, adapting to changing demographic and economic circumstances, or ensuring fiscal sustainability. Local governments should see their role vis-à-vis the Province as one of "partner," rather than of the traditional "dependent." Where the tendency has been to petition Queen's Park for funding and fixes for local issues, the focus should instead be on engaging the Province and working cooperatively to address shared issues. In a report released before the financial crisis, the Toronto Mayor's Fiscal Review Panel presciently stated:

We also recognize that even though the Province has been much more generous recently, the relationship with the Province has still not been thoroughly worked out. There is still much more work to do and the likelihood of the Province being able to "fix" all these matters through "cutting new cheques" is highly unlikely now or at any point. This is especially true if the economy weakens (2008).

4.1 The Pressures on Provincial-Municipal Arrangements

The three major trends identified in this paper are buffeting provincial-municipal arrangements. The first is a growing recognition of the role cities and metropolitan regions play as centres of growth and national prosperity. The second is increasing complexity in the provincial-municipal relationship. The third is the emergence of threats to the fiscal health of Ontario municipalities. These trends, catalyzed by a period of provincial fiscal constraint, will place increasing pressure on the scale and governance of existing provincial-municipal arrangements, on service models and shared responsibilities, and on municipal finances.

The pressures on scale and governance

The growth of cities and metropolitan regions in population, geographic footprint, and economic importance has put increasing pressure on the existing scale of municipal structures and the effectiveness of governance arrangements. Large urban and suburban municipalities face higher demand for services and infrastructure, growing complexity in questions of policy, administration and accountability, and difficulties in coordinating politics, planning and service delivery on a broader regional scale. To accommodate the growing scale and responsibilities in larger centres, regional coordination mechanisms are needed, local governance must mature, and the capacity of public administration should be increased. Conditions and needs are entirely different in Ontario's small, rural communities: in those communities, greater scale, cooperation, and capacity are needed to address economic, fiscal, and geographic isolation pressures.

The pressures on service models in areas of shared responsibility

The growing municipal role in a highly interdependent policy landscape, coupled with fiscal constraints and growing public expectations, is putting pressure on existing service models, particularly in areas of provincial-municipal shared responsibility. The traditional calls for a comprehensive "disentanglement" of responsibilities are increasingly impractical. Instead, there needs to be more cooperation in modernizing policy and program models in the areas that are highly interwoven, and in coordinating relations with the federal government. There could also be more focus on enabling local policy innovation, experimenting with new service models, and reducing some of the constraints on municipal action, with the appropriate provincial oversight mechanisms and supports for local administrators.

The pressures on municipal finances

Despite some media reports, there is no municipal finance crisis in Ontario. But there are a number of pressures on municipal finances that could pose a growing threat to the fiscal health of municipal governments in the years ahead. While increases in provincial funding and service-cost uploads have played a major role in managing these pressures over the past decade, challenging provincial finances makes this less likely looking ahead. All of this suggests that, while the conditions and capacities of local governments vary significantly, there is a clear need to

diversify and enhance local revenue sources, and to identify new strategies to manage local fiscal pressures.

4.2 Modernizing Provincial-Municipal relations

As policymakers are confronted with these pressures, this paper highlights a number of insights and approaches to guide them in modernizing provincial-municipal arrangements:

1. Big cities are different and should be treated differently from small, rural communities.
2. Metropolitan areas and regions require effective governance and coordination mechanisms.
3. Smaller communities could benefit from more cooperation and shared service arrangements.
4. Areas of shared provincial-municipal responsibility need to be better aligned and integrated.
5. There should be more provincial-municipal cooperation in engaging the federal government.
6. Municipal compliance burdens, unfunded mandates, and other constraints should be reduced.
7. Municipal innovation should be encouraged in the modernization of policies and service models.
8. Local governance and public administration have to mature to handle increased responsibility.
9. The infrastructure gap demands new funding sources and more creative “leveraging” of assets.
10. Compensation pressures call for new approaches to labour relations.
11. More flexibility in local revenue sources and more efficient pricing policies are needed.

4.3 The Past Holds Lessons for the Future

There is a long history to provincial-municipal relations in Ontario. Rooted in 19th century laws and early notions of responsible government, the relationship has evolved over the past two centuries. The institutional architecture and political culture today have been shaped by the legacy of a series of seminal trends and events, including Depression-era municipal financial crisis, the postwar period of urbanization and the economic boom that followed, and the turmoil of the 1990s. The last decade, while calmer, has seen a continued deepening of the relationship through further changes to responsibilities, legislative reforms, and major provincial re-investments.

As the size and scope of municipal responsibilities has grown over time, so has the breadth and interconnectedness of the policy, financial, and service delivery interface with the Province, and the differences between large and small municipalities. For both orders of government, the question is not *whether* these pressures will necessitate further reforms, but when they should to avoid the ill-considered responses that inevitably result in times of crisis.

This paper has argued that provincial-municipal relations are approaching an inflection point. As the Smith Committee on Taxation presaged in 1967, “healthy intergovernmental relations in a federal system can be achieved only through continuous and unremitting effort, on the part of all, to adjust to changing circumstances” (Smith 1967). This is as true today as it was nearly 50 years ago.

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