
Financing Municipal Services and Infrastructure in Canada

Enid Slack
Institute on Municipal Finance and Governance
Munk Centre for International Studies
University of Toronto

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Introduction

- The rapid growth in the urban population has created serious challenges for cities around the world:
 - ❑ air and water pollution
 - ❑ transportation gridlock
 - ❑ deteriorating infrastructure
 - ❑ shortage of affordable housing
 - ❑ violence and crime
 - ❑ income polarization

Introduction

- Cities have an important role to play in delivering services and providing infrastructure to address these challenges
- This presentation will outline how Canadian cities finance services and infrastructure

Outline

- Background :
 - Division of powers and responsibilities
 - Municipal expenditures
 - Municipal revenues
 - Role of provincial and federal governments
- Fiscal challenges facing Canadian municipalities
- Financing infrastructure

Division of Powers and Responsibilities

- Canada is a federal country with three levels of government: federal, provincial and municipal
- Under the Canadian Constitution, powers are divided between the federal and provincial governments
- There are 10 provinces and 3 territories
- Municipalities are not recognized in the Constitution except to the extent that they are the responsibility of provinces
- There are about 4,000 municipal governments in Canada

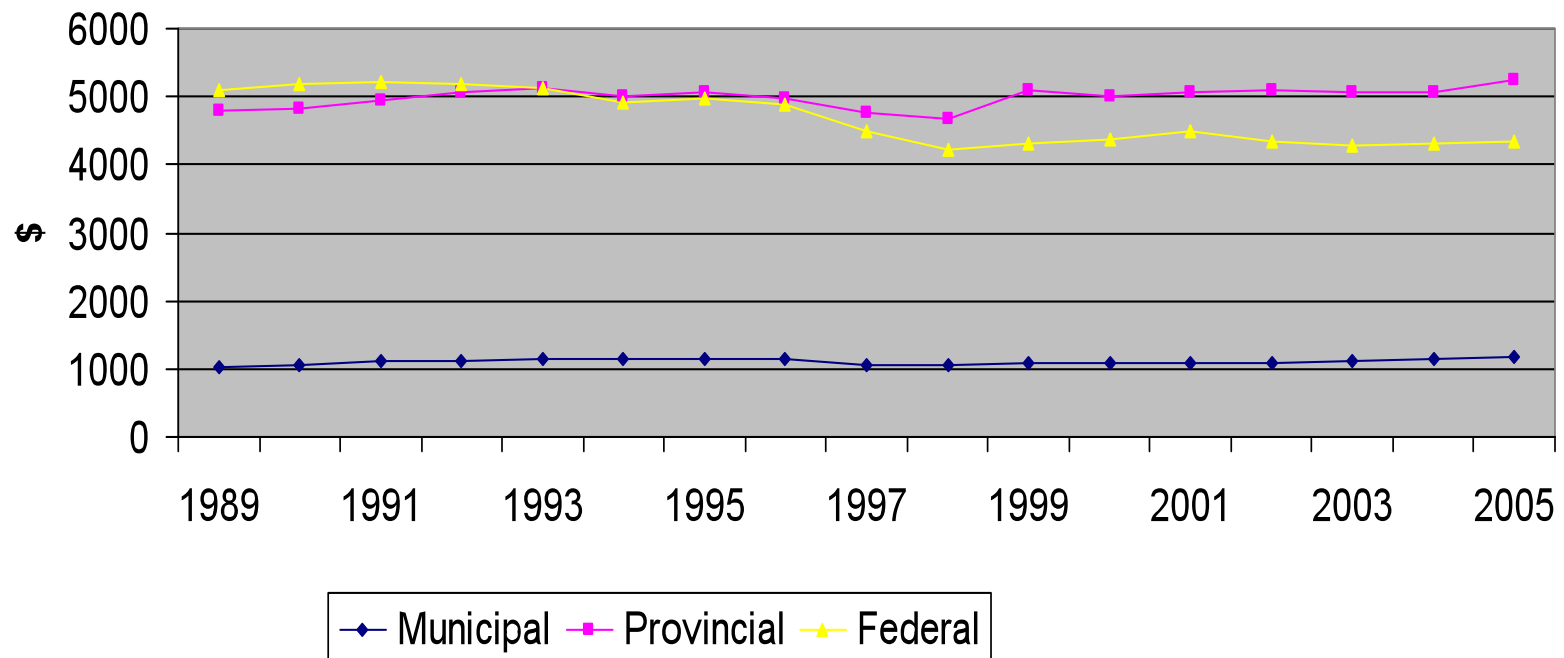
Division of Powers and Responsibilities

- The federal government maintains the "peace, order and good government" of the whole country by making laws with respect to immigration, unemployment insurance, trade and commerce, national defence, native affairs, and criminal law.
- Provincial governments are empowered to control regional and local affairs including education, health, social services, property rights, administration of justice, local public works, and municipal institutions.
- Some responsibilities are shared between the federal and provincial governments such as immigration, agriculture, and pensions.

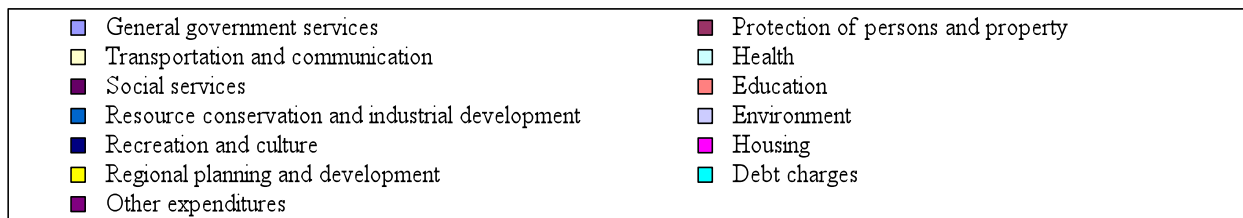
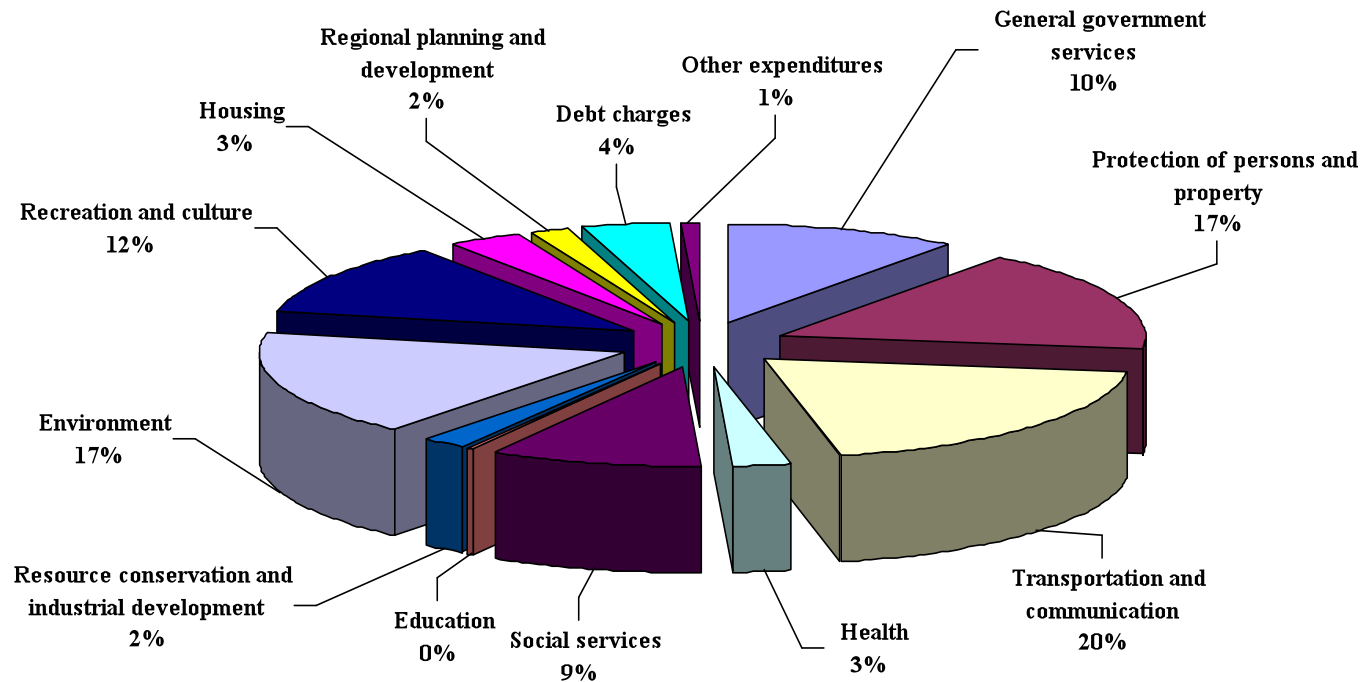
Municipal Government Structure

- Single tier: each municipality is responsible for all municipal services
- Two tier: upper tier (region or county) is responsible for area-wide services; lower tier (cities, towns, villages) are responsible for local services
- Inter-municipal agreements especially among single tiers and lower tiers

**Federal, Provincial and Municipal Government Expenditure,
Constant Dollars per Capita, 1989-2005**



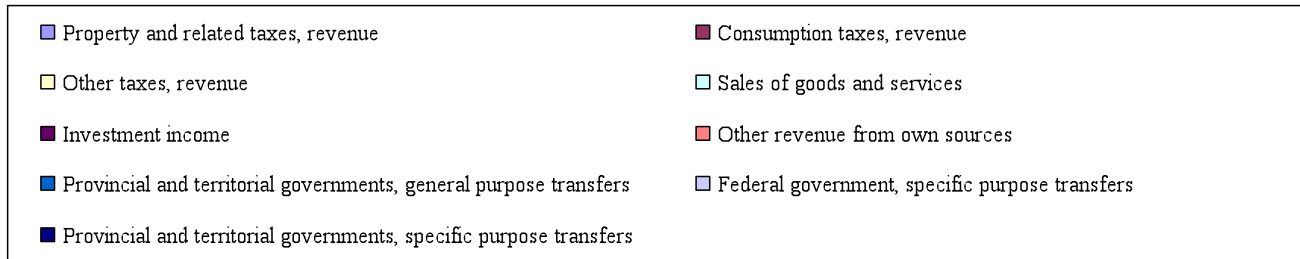
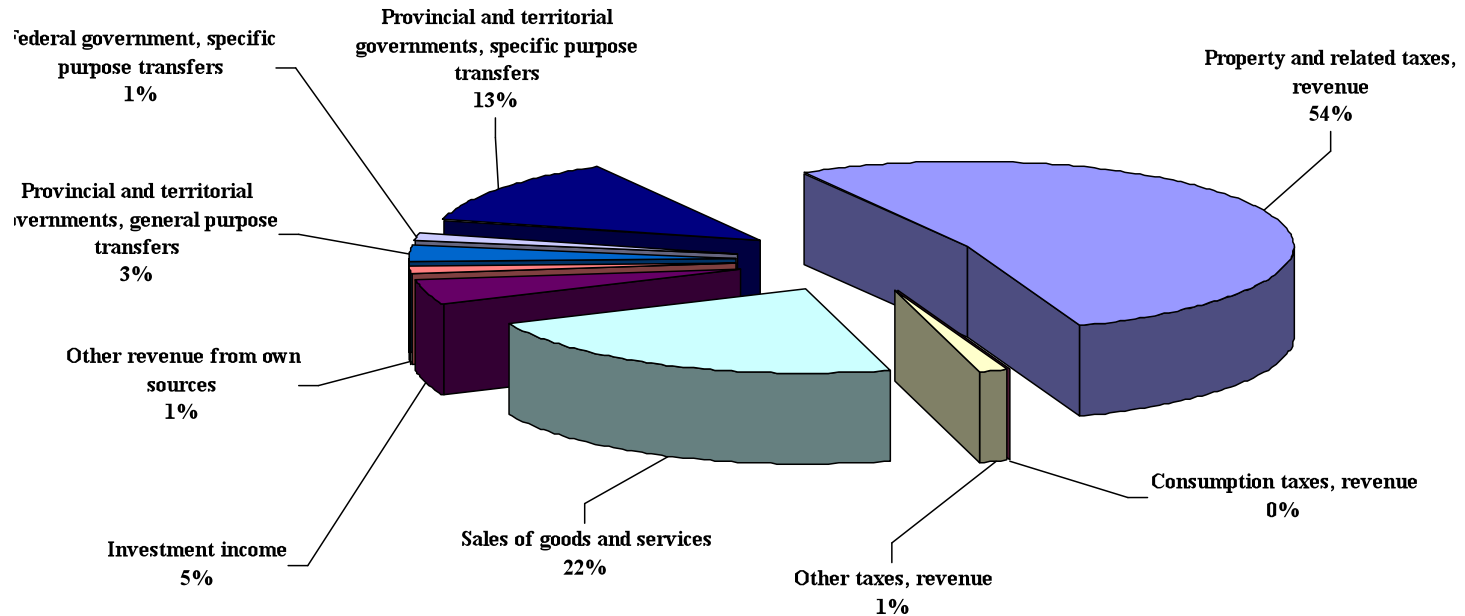
Composition of Total Expenditure by Local General Government, Canada (2005)



Municipal Expenditures

- Largest expenditures on transportation, protection (fire and police) and environment (water, sewers, solid waste)
- Variation by province/territory from \$582 per capita in PEI to \$2,144 in Ontario

Composition of Revenue by Local General Government, Canada (2005)



Municipal Revenues

- Main source of revenue is property tax followed by user fees and provincial transfers
- Most transfers are conditional (specific purpose) transfers
- Largest conditional transfers are for transportation, environment (water, sewers), and social services (in Ontario)

Other Municipal Revenues in Selected Provinces/Cities

- Land transfer tax: Nova Scotia, Québec, permitted in Manitoba, City of Toronto
 - Amusement taxes: Nova Scotia, Manitoba, Saskatchewan, BC
 - Hotel taxes: Nova Scotia, Saskatchewan, Alberta, BC, Québec, permitted in Manitoba
 - Poll tax: Newfoundland, parcel tax in BC
 - Development charges: BC, Alberta, Saskatchewan, Ontario, Yukon, NWT, Halifax Regional Municipality
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Municipal Revenues in Selected Provinces

- Revenue sharing (income tax, fuel tax, VLT/casino revenues, fine revenues): Manitoba
- Provincial fuel tax sharing: BC, Alberta, Ontario, Québec, Manitoba
- Vehicle registration tax: Toronto

Role of Federal Government

- Provides some limited transfers to municipalities, including:
 - transfer based on gas tax revenues
 - infrastructure grants
 - homelessness grants

Role of the Province

- Create or destroy municipalities
- Provincial legislation determines municipal responsibilities and what taxes municipalities can levy
- Provincial governments set standards for service provision
- Municipalities cannot run an operating deficit
- Municipal borrowing is restricted

Role of the Province

- Conditional transfers: main ones for transportation, environment, and social services (in Ontario)
- Unconditional transfers: based on formulas

Provincial-Municipal Unconditional Grants

- Unconditional grants account for less than 20% of all provincial-municipal grants
- Some form of equalization grant is used in most provinces
- Equalization grants are sometimes based on fiscal capacity (measured by the size of the tax base); sometimes also based on expenditure needs; sometimes municipalities are grouped by type or size

Fiscal Challenges Facing Cities

- Offloading of services
- Need to be internationally competitive
- Higher costs associated with urban sprawl
- No diversification of revenue sources

Financing Infrastructure

- How infrastructure is financed depends on the type of infrastructure investment:
 - Services in new developments
 - New services in existing developments
 - Maintenance and replacement of old services
 - Mega projects

A Range of Financing Tools

- Property taxes
 - User fees
 - Development charges
 - Federal and provincial grants
 - Municipal borrowing
 - Public-private partnerships
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Property Taxes

- Tax levied on residential, commercial and industrial properties
- Calculated as a tax rate times the tax base
- Tax base is assessed value of property (usually market value)

Property Taxes: Advantages

- Property is immobile – unable to shift location in response to tax; easy to collect the tax
- Tax related to benefits received from local services
- Tax is visible and accountable

Property Taxes: Disadvantages

- Visibility makes it difficult to increase or reform the tax
- Inelasticity means that the tax does not increase as economy grows
- Not related to benefits received for long-term investments
- Not appropriate for investments that are “lumpy”

User Charges

- Service fees – e.g. license fees
- Public prices – from the sale of private goods and services e.g. water, transit, garbage collection, recreation
- Specific benefit taxes – compulsory contributions to local revenues; related to benefits received e.g. supplementary property taxes to pay for sidewalks or street lighting

User Charges

- Promote efficient use of resources in the public sector (when properly designed) because they provide information to government on how much citizens are willing to pay for services
- Ensure what public sector provides is valued by citizens
- Link expenditures and revenues
- Reduce over-consumption (when consumers are required to pay the cost)
- Give appropriate capital investment signals – reduces demand for infrastructure

User Charges: Problems

- Can be costly to price (e.g. metering for water)
- Need cost information (e.g. need to know long-term capital costs, infrastructure investments)
- Distributional consequences may be undesirable
- Need to be able to identify the beneficiaries and exclude those who don't pay
- Hard to increase public sector prices (e.g. transit fares)
- Rarely implemented correctly

Development Charges

- Also known as lot levies
- Charge per lot or per hectare to cover the growth-related capital cost associated with new development or redevelopment
- Covers cost of off-site infrastructure (e.g. highways, sewer lines, etc.)
- Applicable to new growth or redevelopment

Development Charges: Advantages

- New growth pays for itself and is not a burden on existing taxpayers
- If levied on a development by development basis, development charges can lead to efficient land use decisions

Development Charges: Disadvantages

- Can lead to urban sprawl where municipalities levy a uniform charge regardless of location
- Municipalities may borrow more cheaply than developers

Development Charges

- Appropriate to cover:
 - growth-related costs
 - new developments or redevelopment

Federal or Provincial Grants

- Spillover rationale: benefits of some municipal services (for example, roads) spill over municipal boundaries
- Municipalities under-allocate resources where there are spillovers
- Provincial matching transfer where matching rate is determined by spillovers will result in optimal allocation of resources

Grants - Disadvantages

- Not stable and predictable funding
- Distort local decision-making
- Some municipalities cannot match federal or state/provincial funds
- No incentive to use proper pricing
- Accountability problems because two or more levels of government are funding the same service

Borrowing

- Canadian municipalities can only borrow for capital expenditures
 - Repayment comes from operating revenues (property taxes, user fees)
 - Provincial borrowing guidelines
 - Pooling of debt through provincial financing authorities (lowers costs)
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Borrowing- Advantages

- Synchronizes costs and benefits over time
- Allows for immediate benefit from infrastructure investment
- Allows municipalities to avoid large year-to-year fluctuations in property taxes

Borrowing - Disadvantages

- Debt charges may “crowd out” other municipal expenditures
- Debt charges can constrain local flexibility

Borrowing

- Appropriate to finance:
 - large capital investments (mega projects)
 - New services in existing developments
 - Services in new developments

Public-Private Partnerships

- Partnership between a government body and a private sector party
- Private sector provides infrastructure or services traditionally delivered by the public sector
- Appropriate for infrastructure that is large in scale and that has an identifiable revenue stream (user fees) and measurable results (e.g. roads, bridges, recreational facilities, water and wastewater facilities)
- Canadian municipalities have limited experience with P3s

Public-Private Partnerships: Advantages

- Relieves municipalities of up-front capital costs
- Get facilities built without municipal debt
- Private sector has access to a wider range of borrowing tools (such as revenue bonds)
- May enable additional sources of revenue to be collected (e.g. retail)
- Public sector can draw on private sector experience and skill

Public-Private Partnerships: Disadvantages

- Private sector: risk that the regulatory framework changes and cause delays in the project.
- Public sector: risk that services will not be what the public wants
- Success depends on contractual arrangements and how risks are shared
- Municipalities need to ensure that municipal objectives are being met

Concluding Comments

- Municipalities have an important role to play in delivering services and infrastructure
- Revenue tools need to match expenditure responsibilities
- No one financing tool for infrastructure stands above the rest
 - Choice of tool depends on type of infrastructure investment and type of infrastructure
 - Need a variety of tools