Provincial-Municipal Fiscal Transfers in Canada

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Outline

- Canadian Context
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  - Role of federal and provincial governments
- Provincial-Municipal Transfers
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The Canadian Constitution

- Canada is a federation with three levels of government: federal, provincial and municipal
- Under the Canadian Constitution, powers are divided between the federal and provincial governments
- 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

The Canadian Constitution

- 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.

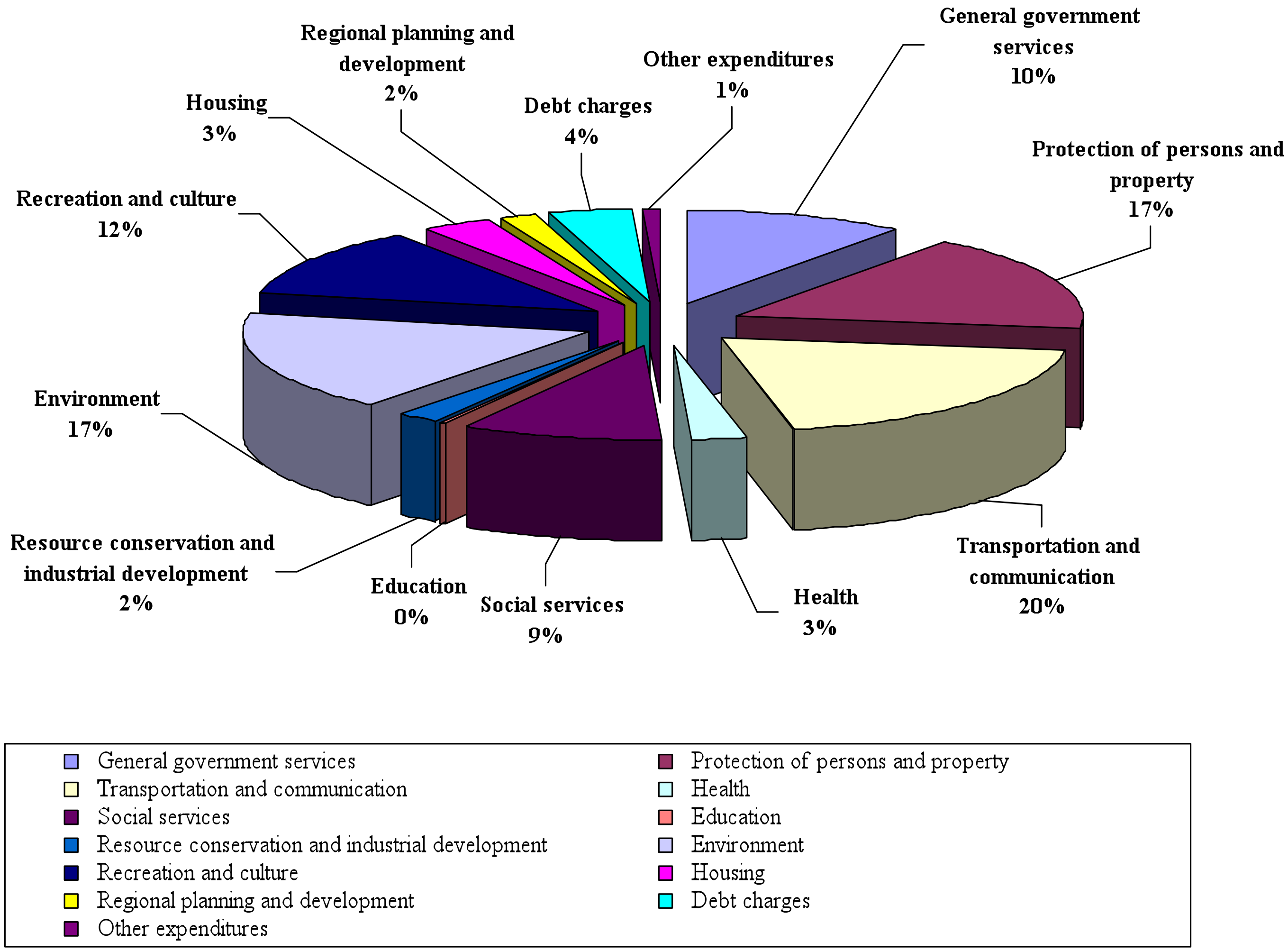
- Provincial governments are empowered to control regional and local affairs including education, health, social services, property rights, administration of justice, local public works, and municipal institutions.

- Some responsibilities are shared between the federal and provincial governments such as immigration, agriculture, and pensions.

Municipal Expenditures

- In 2005, municipal expenditures were $1,814 per capita, on average across the country
- Variation by province/territory from $582 per capita in PEI to $2,144 per capita in Ontario
- Variation reflects differences in population size, degree of urbanization, provincial-municipal division of responsibilities and other factors
- Largest expenditures on transportation, protection (fire and police) and environment (water, sewers, solid waste)

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



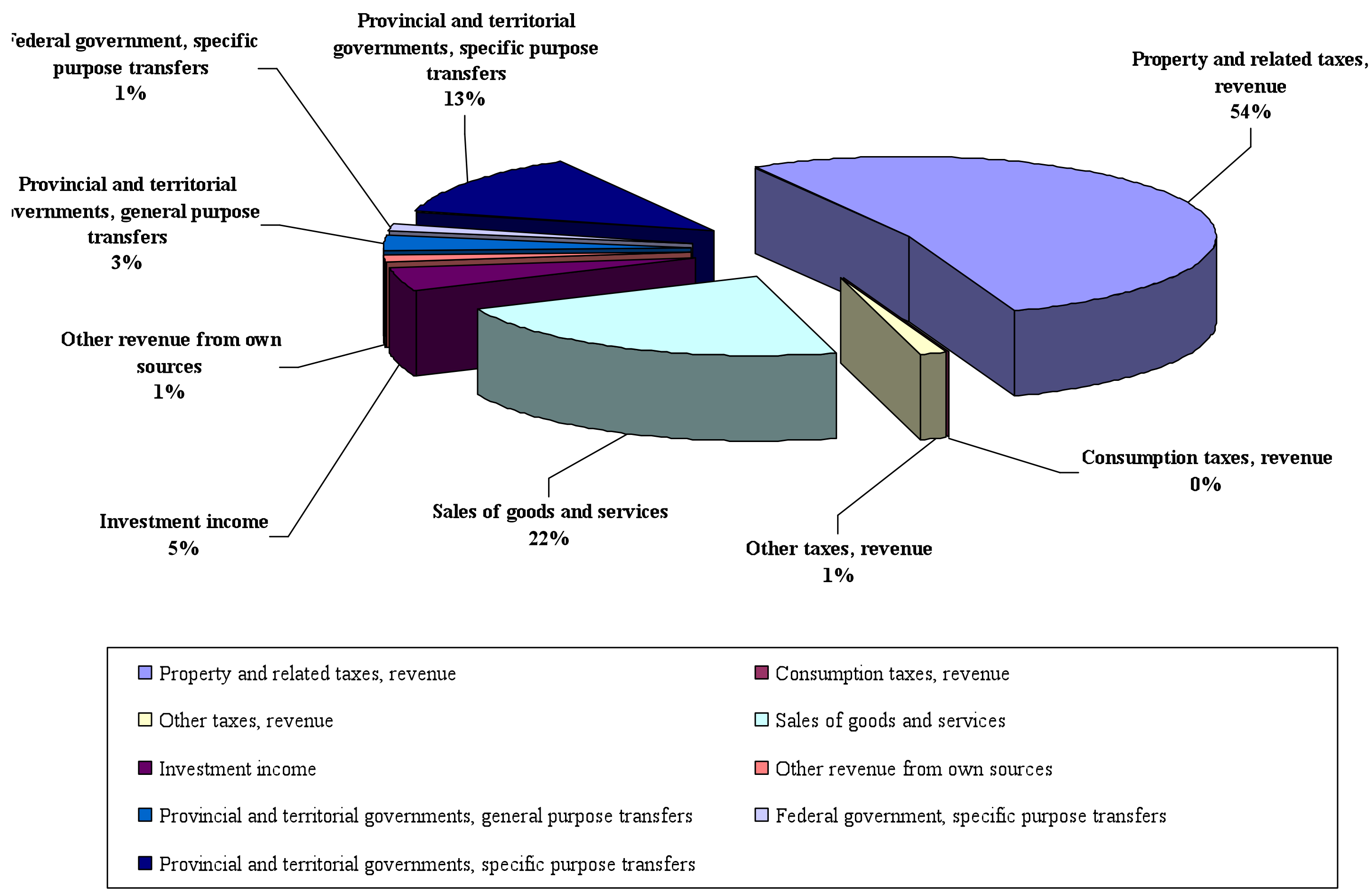
Municipal Revenues

- Main source of revenue is property tax (54%) followed by user fees (22 %) and provincial transfers (16%)

- Most transfers are conditional (specific purpose) transfers

- Largest conditional transfers are for transportation, environment (water, sewers), and social services (in Ontario)

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



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

- Creates or destroys municipalities
- Determines municipal responsibilities and what taxes municipalities can levy
- Sets standards for service delivery
- Prohibits municipalities from running an operating deficit; restricts municipal borrowing for capital expenditures
- Provides conditional and unconditional transfers to municipalities

Provincial-Municipal Transfers

- Unconditional transfers:
  - Per capita
  - Equalization
  - Revenue sharing

- Conditional transfers:
  - Matching (%)
  - Non-matching (lump sum)

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

General Model for Equalization Grants

$$GR_i = (E/POP)^*POP_i - t^*B_i$$

Where:

GR_i = grant to jurisdiction i

$(E/POP)^*$ = standard (average) expenditures per capita

POP_i = population in jurisdiction i

t^* = standard (average) tax rate

B_i = tax base in jurisdiction i

Example of Equalization Transfer -- New Brunswick

- Unconditional grant formula designed to enable each municipality (regardless of the size of its tax base) to:
  - provide an average level of service (when compared to other municipalities)
  - levy a tax rate that is not higher than the average for all municipalities

Example of Equalization Transfer -- New Brunswick

- Municipalities are divided into 6 groups based on characteristics, expenditure pressures, service requirements

- Expenditure need is measured by average per capita expenditures in each group

- Fiscal capacity is measured by the (property) tax base of each municipality multiplied by an average tax rate for the group

Example of Equalization Transfer -- New Brunswick

- A weighting factor is incorporated into the formula to reflect specific characteristics of a municipality such as population density

- A threshold tax rate ensures individual municipalities don’t set an unreasonably low tax rate

Provincial-Municipal Revenue Sharing

- Some provinces share their revenues with municipalities, usually on a per capita basis
- Manitoba is the only province that shares income tax revenues with municipalities on a per capita basis; also shares fuel taxes, video lottery terminal and casino revenues, and provincial fine revenues
- Some other provinces share fuel tax revenues (e.g. BC and Ontario)

Provincial-Municipal Revenue Sharing -- Manitoba

- Province shares with municipalities:
  - 4.15% of provincial income taxes (personal and corporate)
  - 2 cents/litre of provincial gasoline tax revenue
  - 1 cent/litre of provincial diesel fuel tax
  - 10% of video lottery terminal revenues
  - 100% of provincial fine revenues for municipalities which provide own policing

Conditional Transfers

- Matching transfers: province funds a specified percentage of eligible costs for specific services
- Non-matching transfers: province makes a lump sum payment to municipalities for specific services
- An upper limit is generally placed on the amount of provincial funds

Conditional Transfers -- Examples

- Nova Scotia: Grants of up to 50 percent for the cost of eligible infrastructure projects
- Quebec: Conditional grants for the maintenance of rural roads taking into account length, costs of winter maintenance, and use of the road (resource extraction or not).
- Alberta: $3 billion over 5 years for municipal infrastructure
- BC: Community water improvement program provides up to 2/3 of the cost of eligible projects

Conditional Transfers – Reporting and Accountability

- There is no guarantee that provincial funds will be used for the intended purpose if a municipality is already spending significant amounts on those functions

- However, there are some mechanisms to determine if the funds are being spent on eligible functions and if there are positive outcomes

Conditional Transfers – Reporting and Accountability

- Eligibility requirements (eligible projects/ eligible costs)
- Financial reporting (revenues and expenditures)
- Performance measures
- Audits
- Program evaluation
- Oversight committees (e.g. federal gas tax revenue sharing)