
Municipal Fiscal Imbalance Across Canada

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Introduction

- Debate over fiscal imbalance in Canada has mainly focused on federal-provincial/territorial imbalance
- There has not been much discussion until recently about municipal fiscal imbalance (FCM report)

Outline of Presentation

- Is there a municipal fiscal imbalance?
- What is different about the municipal debate compared to the federal-provincial debate?
- What can municipalities do to reduce the fiscal imbalance?
- What else needs to be done?

Is There a Municipal Fiscal Imbalance?

- ❑ Do municipalities have sufficient revenue-raising capacity to meet their expenditure needs?
- ❑ Can municipalities raise existing revenues (e.g. property taxes and user fees) to meet expenditure requirements?
- ❑ Let's look at recent trends in municipal expenditures and revenues; the fiscal challenges facing municipalities; and how well they have fared

Municipal Expenditures, 2004

	Canada	Manitoba
Transportation	20%	25%
Fire and police protection	17%	20%
Water, sewers, garbage	16%	17%
Health/social services/social housing	16%	3%
Recreation and culture	13%	11%
General government	10%	15%
Debt charges	4%	5%
Planning and development	2%	1%
Other	2%	3%

Municipal Revenues, 2004

	Canada	Manitoba
Property Taxes	53%	43%
User Fees	22%	24%
Provincial Grants	15%	21%
Federal Grants	1%	1%
Investment Income	5%	7%
Other Revenues	4%	4%

Trends in Municipal Finance in Canada

- Over the period from 1988 to 2004, municipal expenditures in Canada increased steadily but their revenue-raising tools have not changed
- Municipal expenditures (per capita constant \$) increased by 0.9 percent per year, on average
- Municipal revenues (per capita constant \$) increased by 0.7% per year, on average

Trends in Municipal Expenditures

- Which expenditures have increased as % of total expenditures?
 - Protection (fire and police), recreation and culture, environmental (water, sewers, garbage)
- Which expenditures have decreased as % of total expenditures?
 - Transportation, general administration, planning, debt charges

Trends in Municipal Revenues

- Which revenues have increased as % of total revenues?
 - Property taxes increased from 49% of revenues in 1988 to 53% in 2004
 - User fees rose from 20% to 23%
- Which revenues have decreased as % of total revenues?
 - Intergovernmental transfers fell from 23% to 16%; mainly decline in provincial with some increase in federal transfers

Fiscal Challenges Facing Large Municipalities

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

Fiscal Challenges Facing Small, Rural, Remote Municipalities

- Offloading
- High per capita expenditures because of distances, inability to achieve economies of scale
- Small tax base restricts ability to raise revenues
- High cost of services means user fees can only cover a small portion of the cost

Is There a Fiscal Imbalance?

- Municipalities have done well on fiscal measures:
 - Size of the operating deficit (no fiscal imbalance)
 - Amount of borrowing for capital
 - Size of reserves
 - Rate of property tax increases
 - Reliance on provincial grants
 - Extent of tax arrears

Is There a Fiscal Imbalance?

- *Fiscal* health may be achieved at the expense of the *overall* health of Canadian municipalities:
 - The state of municipal infrastructure (water, sewers, roads, recreational facilities, etc.)
 - The quality of service delivery (e.g. performance measures)
 - Infrastructure and services are difficult to measure

Is There a Municipal Fiscal Imbalance?

- Estimates of infrastructure deficit: \$60 to \$125 billion
- Problems with studies:
 - some cover all municipal infrastructure; others cover only specific types of infrastructure
 - some separate replacement and rehabilitation from investment needs while others do not
 - data from surveys reflect vested interest in overstating the infrastructure deficit
 - most assume no policy changes in the future (e.g. efficient user fees that will result in curbing demand).
- Nevertheless, there is an emerging consensus that there is a substantial infrastructure deficit in Canada's cities

Is There A Municipal Fiscal Imbalance?

- ❑ Canadian municipalities do not suffer from a fiscal imbalance because they have to balance their budgets by law and they are restricted in terms of how much they can borrow for capital
- ❑ Fiscal balance may have been achieved at expense of infrastructure and services

The Federal-Provincial Fiscal Imbalance Debate

- Provinces argue that the federal government has more fiscal capacity than it needs to meet its expenditure requirements; provincial governments have less fiscal capacity than they need to meet their expenditure requirements
- It is going to get worse because of rising health care costs

The Fiscal Imbalance Debate

- Federal government argues that provincial governments have access to the same tax bases as federal government (mainly income and sales taxes); why not raise taxes?
- Can the provinces raise their taxes?
- Provinces argue that they are at the limit
- Fortunately, we don't have to answer that question today

What is Different about the Debate at the Municipal Level?

- Municipalities are different than federal and provincial governments:
 - Municipalities are constrained by provincial governments in terms of the expenditures they are required to make and the revenues they can raise; less flexibility on expenditure and tax decisions
 - Municipalities rely largely on property taxes to meet expenditure requirements; do not have access to income and sales taxes

What is Different about the Debate at the Municipal Level?

- Unique characteristics of property tax:
 - Inelastic tax
 - Growth may be limited in the future by aging population (drop in housing starts), downsizing and limited growth in housing prices (Conference Board)
 - Ability to increase non-residential taxes limited because of over-taxation relative to services
 - Visibility restricts increases (revenue neutrality)

What Can Municipalities Do?

- Can municipalities increase their own revenues?
 - ❑ There may be more room in residential property tax in some municipalities but not in non-residential property tax
 - ❑ Correct pricing would reduce demand for services and infrastructure: water, transit, garbage etc.
 - ❑ Municipalities could borrow more: borrowing makes sense for infrastructure
 - ❑ Measures still likely to fall short of what is needed

What Else Can be Done?

- Upload expenditures and/or
- Download revenue-raising tools to municipalities

Concluding Comments

- There is probably a fiscal imbalance at the municipal level but it is difficult to measure
- The debate at the local level is different at the federal/provincial level
- Municipalities could probably raise revenues more
- But it will still not be enough – need to upload expenditures or download revenue tools