CITIES IN CANADIAN FEDERALISM

Enid Slack and Richard M. Bird

"Canada's large cities are nice places to live," write Enid Slack and Richard M. Bird of the University of Toronto's Institute on Municipal Finance and Governance. Our cities still do remarkably well in international surveys, but these good times may not last: they warn that the substantial infrastructure deficit is draining Canadian cities' competitive advantage. The issue, they say, is not so much a fiscal one, as cities have not run deficits and have not borrowed heavily. Rather, what is at stake is the ability of municipalities to provide the services that people want at reasonable tax rates. They review how the federal, provincial and municipal governments can change the situation: what cities need, they say, is access to revenue sources for which they themselves are responsible and accountable.

« Il fait bon vivre dans les grandes villes canadiennes », écrivent Enid Slack et Richard M. Bird, du Institute on Municipal Finance and Governance de l'Université de Toronto. Mais si nos villes continuent de faire très bonne figure dans les enquêtes internationales, les choses pourraient changer assez rapidement. Leurs lacunes en matière d'infrastructures risquent en effet d'amoindrir leur atout concurrentiel. Le problème n'est pas vraiment financier, puisqu'elles n'accumulent aucun déficit et ne sont pas endettées outre mesure. L'enjeu réside plutôt dans leur capacité de fournir à un taux d'imposition raisonnable les services recherchés par les citoyens. Considérant ce que peuvent faire les gouvernements fédéral, provinciaux et municipaux pour améliorer la situation, les auteurs estiment que les villes ont besoin d'un meilleur accès à des sources de revenus dont elles seraient elles-mêmes responsables et tenues de rendre compte.

Canada's large cities are nice places to live. In terms of quality of life, Canadian cities consistently perform well in surveys. One well-known survey of cities around the world (by Mercer Human Resources) reveals Vancouver as a contender for the top spot. Toronto, Montreal, Ottawa and Calgary also rank in the top 25. Canadian cities do well because they have a quality of social and cultural infrastructure similar to that of US cities, but an appreciably higher quality of personal security. The good times are here. But they may not last.

Although by most measures, the fiscal condition of Canadian cities seems fairly good, we argue that beneath this happy picture lies a less happy reality. Owing to the limited and relatively inelastic revenue base to which even the largest cities have access, the foundation of Canada's urban prosperity is being eroded, with potentially damaging implications for national well-being in the long term. In an important sense, the roots of this problem lie in the fact that cities do not have any real role or voice in Canada's federal structure. Since neither role nor voice is likely to be bestowed on them in the near future, we conclude by laying out some less fundamental actions that all levels of government will have to undertake if they wish to maintain not only the present reputation of Canada's big cities as "a nice place to live," but also something even more basic: the dynamic that, according to all the evidence, increasingly underpins economic growth.

Recent events have led to increasing concern about the ability of Canadian municipalities to provide the services that people want and still maintain reasonable tax rates. One of Canada's proudest economic achievements recently was its rapid move in the 1990s to the head of the OECD league table of the great, good and fiscally sound. Unfortunately, this achievement rested in part on transferring some of the deficits to those at the bottom of the fiscal food chain — local governments. One way to do this was simply to "offload" services directly to municipalities, as was the case in Ontario with some social services and social housing expenditures. Provincial governments also reduced transfers to municipalities. Upper-tier governments reduced their own expenditures in services that impacted localities, such as immigration settlement and, in some provinces, education. Moreover, the federal and provincial governments imposed service standards — for example, water quality standards — on municipalities without providing the resources. The objectives of such policies may be sound, but municipalities are left to foot the bill. All this offloading placed considerable fiscal pressure on local governments.

While it is difficult to measure the state of service delivery in any quantitatively comparable way, some studies have attempted to measure the magnitude of the "infrastructure gap," and estimates range from $60 billion to $125 billion. Even the lowest estimate is huge, since the total local public infrastructure capital stock was estimated to be only $82.4 billion in 2002. The evidence supports the emerging consensus that there is a substantial infrastructure deficit in Canada's cities.

Other factors — the need to compete in the international marketplace to attract business and skilled labour and the infrastructure demands of automobile-driven suburbs — also increased the pressure on the expenditure side of city budgets. But municipal revenues have not kept pace. Property taxes do not expand automatically with economic growth, as do income and sales taxes. The need for local governments to get citizens' support for highly visible tax (and fee) increases certainly makes them more accountable than higher-level governments. But it also makes it more difficult for them to cope with rising expenditures.

Expenditures up, transfers down and hard-to-increase own-source revenues: it sounds like a prescription for fiscal crisis. It is thus not surprising that there has been much concern about the fiscal sustainability of Canadian cities in recent years. Nonetheless, no urban fiscal crisis is yet apparent, nor is one likely suddenly to appear. Canadian municipalities have not run deficits in their operating budgets since they are explicitly prohibited from doing so by provincial legislation. Moreover, few (if any) cities have borrowed excessively to pay for capital expenditures. One reason is again because they can't: the amount localities can borrow is constrained by provincial governments, although this is not the whole story; even when provincial controls were substantially relaxed in the 1990s, Canadian cities did not come close to utilizing either their legal or their market debt capacity.

Like debt, local taxes have not risen much in recent years. Toronto, for example, did not increase property taxes at all between 1998 and 2000, and it has increased them only 3 percent annually since then. All in all, from a fiscal perspective, the only conclusion one can reasonably reach from the data is that municipalities are almost disgustingly healthy. What possible basis could there be for our earlier intimations of impending disaster? Where's the beef?

Municipal accounting does not tell the whole story. The overall health of cities depends less on balancing their budgets than on the adequacy of the services provided and the current state of municipal infrastructure. While it is difficult to measure the state of service delivery in any quantitatively comparable way, some studies have attempted to measure the magnitude of the "infrastructure gap," and estimates range from $60 billion to $125 billion. Even the lowest estimate is huge, since the total local public infrastructure capital stock was estimated to be only $82.4 billion in 2002. The evidence supports the emerging consensus that there is a substantial infrastructure deficit in Canada's cities, especially the larger ones, and that this deficit is becoming a serious competitive disadvantage for those cities and for the country as a whole.

The high degree of provincial control over local governments in Canada means that there cannot be any visible fiscal crisis at the local level: municipal governments are strictly held to balanced budgets for operating purposes, and their borrowing for capital expenditures is constrained by provincial regulations. The other side of the coin, however, is that municipal governments have only very limited fiscal autonomy and are constrained from solving any real (as opposed to on-the-books) fiscal problems they may have.

Most transfers to local governments come from the provinces and are conditional: they must be spent on specific functions and only for eligible costs, although a few provinces provide limited equalization grants. Four provinces have some limited revenue sharing. In British Columbia, 11 cents per litre of the provincial tax on fuel is transferred to the Greater Vancouver Transportation Authority (TransLink) for the capital and operating expenditures of public transit and major roads in the Vancouver region. In Alberta, Calgary and Edmonton receive 5 cents per litre of taxable gasoline and diesel fuel delivered to service stations in those cities, for transportation infrastructure. In Quebec, the Agence Métropolitaine de Transport gets 1.5 cents per litre of provincial taxes collected on motor fuel sold in the Greater Montreal Area. The only province that has a more general, unconditional revenue-sharing system is Manitoba, where the provincial government shares personal and corporate income tax revenues, fuel tax revenues, revenues from video lottery terminals and casinos, and provincial fine revenues with municipalities. In all these cases, how the tax is levied, collected and distributed is unilaterally decided by the province and can be changed at will.

After a long period of quiescence, the federal government, flush with funds, recently responded to local demands by presenting initiatives such as a proposal to share up to 5 cents per litre of gasoline on a (roughly) per capita basis to municipalities, a rebate on the goods and services tax (GST) for municipalities, more funding for public transit and housing, and a commitment to renew existing infrastructure funding programs. In 2005, the government appointed a minister of state for infrastructure and communities to spearhead a "new deal" for cities and communities. It also established the External Advisory Committee on Cities and Communities, which will report to the prime minister, and — a real first — invited municipal representatives to participate in federal budget consultations. In the 2006 federal election, the Conservative Party promised to include municipalities, along with the federal and provincial/territorial governments, in discussions to resolve the so-called fiscal imbalance. The federal-municipal connection thus seems to be not only alive but growing. But what does it really amount to?

As the tables show, explicit federal involvement in municipalities does not amount to much. It focuses almost entirely on infrastructure (see table 1a) and homelessness (see table 1b). For instance, under the Infrastructure Canada Program, introduced in 2000, the government committed funds over a six-year period for clean air and water, transportation and affordable housing. Cities welcome this kind of direct relationship with the federal government because it generally means they will receive additional funding. But cities remain creatures of the provinces, and provincial governments have not been keen to cede any of this authority to the federal government. The federal government can give money to cities, but it cannot change their expenditure responsibilities or their revenue-raising tools. The federal government can say whatever it wishes about a new deal for cities, but any real deal will essentially depend on provincial involvement and consent.

Still, there are at least three reasons why the federal government should care about cities. The first and most obvious reason is simply that most Canadians live in cities: about two-thirds already live in census metropolitan areas with populations over 100,000. Forty-five percent live in the six major city-regions, where more than 80 percent of future economic and population growth is expected to occur. What happens in these city-regions has important consequences for the future of the country. Large cities and city-regions are the main drivers of economic prosperity, both for the provinces in which they are located and for the country as a whole.

The second reason is that many federal policies have an impact on

TABLE 1A. FEDERAL-MUNICIPAL FUNDING PROGRAMS

Program	Description	Funding amount ($ millions)
Infrastructure programs		
Canada Strategic Infrastructure Fund	Up to 50% of the cost of large-scale strategic infrastructure projects that further economic growth and improve quality of life (in partnership with provincial/territorial and municipal governments).	4,000 over 6 years
Border Infrastructure Fund	Up to 50% of the costs of infrastructure projects to reduce border congestion at Canada-US border crossings.	600 over 5 years
Municipal Rural Infrastructure Program	Base allocation of $15 million and the rest on a per capita basis for smaller-scale infrastructure, particularly for smaller communities.	1,000 over 5 years
Infrastructure Canada Program	Created in 2000 to upgrade infrastructure in urban and rural communities. Partnership of federal government (1/3), provincial/territorial governments (1/3) and municipal governments (1/3).	2,050 over 6 years
Green Municipal Funds	Established in 2000 to stimulate investment in innovative municipal infrastructure projects and feasibility studies to improve air, water and soil quality and to reduce greenhouse gas emissions. Funds are managed by the Federation of Canadian Municipalities.	550 over 5 years
Sharing Federal Gas Tax Revenues	Starting in 2005, directs a portion of federal gas tax revenues (up to 5 cents per litre) on roughly a per capita basis to municipalities through respective provinces/territories. Funds have to be spent on environmentally sustainable municipal infrastructure (including roads).	5,000 over 5 years
Additional support for public transit	Funds for public transit allocated to provinces on a per capita basis with stipulation that provinces allocate funds to municipalities and transit agencies on the basis of ridership.	800 over 2 years

cities. Policies such as those dealing with immigration, Aboriginal people, housing, air transportation and international commitments such as the Kyoto Protocol all affect cities in fundamental ways. If Ottawa funded services to immigrant and Aboriginal populations in urban areas adequately, so cities did not have to take up so much of the slack, it would go a long way toward helping cities. But there is no institutional forum that permits or encourages direct federal-local interaction on any of these issues.

Ideally, urban regions should be consulted in important areas that affect them directly. Immigration, for example, is a largely urban phenomenon, yet there is no formal mechanism for cities to be involved in immigration matters. Federal programs for the urban Aboriginal population are designed in collaboration with provincial/territorial governments but not with municipalities. More coordination among all three levels of government is needed. There are examples of such coordination: Urban Development Agreements in Vancouver, Edmonton and Winnipeg, for instance, and the Infrastructure Canada Program (see table 1a).

The third reason is that Canadian cities face serious challenges if they want to maintain their economic competitiveness in North America, let alone in the world. Thirty years ago, if you crossed the border from New York State to Ontario, almost the first thing you noticed was how much better the roads were in Canada. To experience a similar joy in driving today, one has to cross in the other direction. The bumps in the roads on the Canadian side confirm that the investment in infrastructure such as transit, roads, water and sewers to support continued economic growth falls short of what is required. Investment in arts and the cultural facilities that will attract the "creative class" is also needed for cities to be competitive. Poverty and homelessness are on the rise, despite economic growth. Urban sprawl has resulted in not only more traffic but also more pollution and higher costs to deliver municipal services. There is no fiscal crisis on the local finance books, but one is clearly percolating underground and underfoot in Canada's larger cities.

Thus it is critical that the federal government continue the work of mapping out the dimensions of the problem, work that Statistics Canada has begun with studies like those from which we have drawn much of our data. Little information is available on the state of the infrastructure in Canada's cities or on how service delivery has changed over the last decade. Municipalities do not regularly evaluate their infrastructure. They need to undertake more systematic

Ontario introduced some municipal performance-based measures in 2000, but many of these measures are based on expenditures per capita and not on the quality of service delivery or the state of the infrastructure. At present, there is no sound empirical basis on which to assess whether and to what extent service delivery is improving or deteriorating. All one can do is to assemble bits and pieces of argument and scraps of data, as we have done here. This is not good enough.

TABLE 1B. FEDERAL-MUNICIPAL FUNDING PROGRAMS

Program	Description	Funding amount ($ millions)
National Homelessness Initiative		
Supporting Communities Partnership Initiative (SCPI)	Provides financial support to communities to increase range of services along continuum from homelessness to self-sufficiency, including emergency shelters, transitional/supportive housing and prevention. Encourages them to work with provincial/territorial and municipal governments and private and voluntary sectors.	258 over 3 years
Regional Homelessness Fund	Provides support to small and rural communities experiencing homelessness.	13 over 3 years
National Research Program	Provides funds to research magnitude, characteristics and causes of homelessness.	7 over 3 years
Homeless Individuals and Families Information System (HIFIS)	National database on size and scope of homeless population, number of shelters, etc.	n.a.
Urban Aboriginal Homelessness	Provides funds to address unique needs of Aboriginal population.	45 over 3 years
Surplus Federal Real Property for Homelessness Initiative	Transfer of properties to help with projects addressing homelessness.	18 over 4 years

study of the state of their infrastructure and the investment required to rehabilitate it, and of service delivery and how it has changed. The provinces, too, need to do much more work along these lines. For example, Ontario introduced some municipal performance-based measures in 2000, but many of these measures are based on expenditures per capita and not on the quality of service delivery or the state of the infrastructure. At present, there is no sound empirical basis on which to assess whether and to what extent service delivery is improving or deteriorating. All one can do is to assemble bits and pieces of argument and scraps of data, as we have done here. This is not good enough.

Contrary to what most mayors seem to think, however, the appropriate role of the federal government is not simply to give money to the cities. Cities' real problem is that to meet their expenditures, they need to have adequate revenue sources. For this cities need more fiscal power. Only the provinces can grant this. The federal government is very much a third wheel when it comes to municipal fiscal issues.

The lack of reliable information has not stopped provincial governments throughout the land from regularly telling cities what to do, and what cities actually do depends on what their provincial governments let them do. Any new deal for cities will require provincial governments to match expenditure responsibilities and revenue-raising tools at the municipal level. Many provinces have realized that something is amiss, and over the years they have engaged in local services realignment exercises in an effort to determine what services the provincial government should fund and what services municipal governments should fund. The outcomes of these exercises — notably in Ontario — have not always been sensible. At the end of the day, cities need to have revenue-raising tools that match their expenditure responsibilities, and they need to have the autonomy to make the decisions that will make them prosperous.

Most cities have some room to increase residential property taxes and user fees. In Toronto, where dinner party conversation often consists of gloating about the ever-rising price of one's house, while simultaneously deploring the grinding burden imposed on the poor homeowner by unfair property taxes, the fact is that the effective tax burden on residences in real terms has increased little over the last two decades and is significantly lower than in the surrounding cities. It is hard to believe that it is impossible to raise residential property taxes. Of course, it would be unpopular to do so, and no sensible politician would ever do it if he or she could get money from someone else, but it certainly can be done. On the other hand, in cities like Toronto, increasing taxes on business property is always politically more attractive to politicians facing reelection than raising taxes on residences. Often, however, city taxes on business are already both well above the level of any services received by business and higher than in neighbouring localities so the result is likely to be to chase away tax base.

Governments are most accountable when those who make decisions on spending and taxes are politically responsible to the people who receive the benefits from spending and pay the taxes. When the level of government making the spending decisions (municipalities) is not the same as that raising the money (provincial or federal governments), accountability is blurred. Whenever possible, local governments should therefore be given not money but the chance (and the challenge) to raise money on their own. They should be fully accountable to their citizens for the taxes and fees they impose to finance the services they provide. It is always more pleasant to receive money from on high, but such largesse is seldom either reliable (as federal and provincial priorities change over time) or free (as grants tend to reflect the priorities of the donor government and not necessarily those of cities).

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When the province or even the federal government sets tax rates for the benefit of localities, not only is accountability blurred, but the funds flowing from such actions have often proved to be unstable and unpredictable. In 2000 Alberta gave Calgary and Edmonton 5 cents per litre of taxable gasoline and diesel fuel delivered to service stations in those cities, with the proviso that the funds had to be used for transportation infrastructure. The following year, the province announced that it was going to reduce the fuel tax funding to 4.25 cents per litre. In the end, it did not reduce the funding: but it could do it, or indeed anything it wants to, at any time. Those who depend on the mercy of princes seldom sleep easily.

Should cities be given access to other tax sources, and if so, which ones? An income tax piggybacked on the federal or provincial tax with locally set rates has clear advantages in terms of local autonomy, accountability, and revenue elasticity, though there are obvious problems in imposing such taxes at the local level. Business income is especially difficult to tax, both because of its mobility across jurisdictions and because business capital is already generally overtaxed by the property tax. Solutions such as only taxing employment income are possible, but present their own problems. Local surtaxes on the provincial tax in those provinces that have a retail sales tax would be technically feasible but would clearly be a bad idea economically, not least because such taxes would again tax business inputs heavily. In provinces with value-added taxes (which do not tax inputs), local surtaxes may be technically feasible, but they are unlikely to be politically acceptable in the near future.

Hotel and motel occupancy taxes (currently levied in Vancouver, Victoria, and Montreal, and on a voluntary basis in the Greater Toronto Area) are an additional levy imposed on the provincial retail sales tax rate on hotels and motels. The usual justification for imposing this tax at the local level is to compensate cities for the services they provide to tourists or visitors (additional police and fire protection, public transit, etc.). A fuel tax has been recommended on the grounds that, if the funds are earmarked for local roads and transit, the tax can be viewed as a benefits tax. Moreover, it should help curb urban sprawl by discouraging road use. Both these taxes would obviously be more feasible if imposed on a city-region basis.

Someone once said that even the most determined efforts of small groups of private citizens had little effect on the world, to which someone else replied that in the end such efforts were the only thing that did have an effect on the world. The second speaker had it right: in the absence of real bottom-up citizen initiative and persistence, it is unlikely that the small number of people and organizations concerned with metropolitan issues will be able to achieve any useful policy outcomes in time to sustain and improve the lively urban environments the country is now fortunate enough to possess. In the end, the future of Canadian cities ultimately depends on what their citizens want, and are willing to work toward and pay for. This is as it should be in a democratic system.

Indeed, cities would work better in Canada (in fact in most countries) if more things were dealt with on a city-region basis. A regional structure is needed to address region-wide problems. Increasingly, the issues faced by larger cities — economic competitiveness, transportation gridlock, loss of agricultural land, what to do with environmentally sensitive areas, urban sprawl, air and water pollution, social polarization, and inadequate fiscal resources — can only be solved at the regional level. The interdependencies and externalities among local jurisdictions need to be tackled on a coordinated and region-wide basis. Cases in which the boundaries of formal government structures correspond with city regions are rare. Most metropolitan regions suffer from political fragmentation and physical sprawl. These problems can be solved. Provincial governments could, if they wished, create effective governance structures for their metropolitan regions. For the most part, however, they have chosen not to do so, perhaps for fear of political competition.

What can cities do when those legally in charge fail to recognize the realities and needs of modern metropolitan life? They can do more than they have done to date. Unfortunately, doing more would clearly not be in the interests of local politicians. In the Greater Toronto Area, for example, attempts to establish a regional body to deal with problems such as transportation and social services have not been very successful. One reason for this is Toronto politicians are afraid that they would be outvoted on such a body and the rest are afraid that Toronto is so big that it would dominate it. Similar institutional blockages exist to a greater or lesser degree in all Canada's metropolitan areas.

The solutions are neither obvious nor simple. All we can suggest here are two things. First, success is most likely when a package that has something for everybody can be put together and the localities are induced to join voluntarily. Second, even if some brave local (or provincial) politicians are willing to stick out their necks and lead the way, such initiatives are unlikely to get anywhere without real public concern and support.

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