Local Governments in the 21st Century: What are the Funding Options?

Presentation to the Municipal Finance Authority of British Columbia
Victoria, BC
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University of Toronto
Key Takeaways

• Municipalities in Canada are fiscally healthy but fiscal health may have been at the expense of overall health – services and infrastructure

• Local governments would benefit from a mix of taxes

• Link taxes to expenditures
Outline of Presentation

• A little bit about IMFG

• State of municipal finances
  • British Columbia
  • Comparisons with Ontario, Alberta, Quebec
  • International comparisons

• Linking taxes to expenditures

• Selected revenue options

• Final observations
IMFG (est. 2004) is the only institute of its kind in North America, which focuses exclusively on the municipal finance and governance challenges facing cities and large city regions.

**Focus**
As the size and scope of responsibilities for cities expands, do local governments have the appropriate financial and governance arrangements to effectively and efficiently deliver services to residents?

**Mandate**
- Conduct independent research
- Spark and inform public debate
- Engage the academic and policy communities

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website: munkschool.utoronto.ca/imfg/
IMFG’s Activities

Produce neutral, evidence-based research publications

Disseminate findings through events, seminars, and roundtables

Offer fellowships to graduate students and early-career academics

Host visiting scholars to share lessons from around the world

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Recent Publications

*Cities, Data, and Digital Innovation*, by Mark Kleinman

*Cost Overruns on Infrastructure Projects: Patterns, Causes, and Cures*, by Matti Siemiatycki

*Municipal Employee Pension Plans in Canada: An Overview*, by Bob Baldwin

*A Good Crisis: Canadian Municipal Credit Conditions After the Lehman Brothers Bankruptcy*, by Kyle Hanniman

*How to Reform the Property Tax: Lessons from Around the World*, by Enid Slack and Richard M. Bird

*IMFG@10: The Past, Present, and Future of City Finance and Governance*, by Richard M. Bird, Alan Broadbent, Enid Slack, and Zack Taylor

And more...

[Website: munkschool.utoronto.ca/imfg/](munkschool.utoronto.ca/imfg/)
State of Municipal Finances
Municipal Expenditures Per Capita, 2013

- General public services
- Public order and safety
- Economic affairs
- Environmental protection
- Housing and community support
- Health
- Recreation and culture
- Social protection

British Columbia
Alberta
Ontario
Quebec
Distribution of Municipal Revenues, BC, 2013

- Property and related taxes: 49%
- User fees: 34%
- Transfers: 4%
- Other taxes: 9%
- Other revenues: 4%
Distribution of Municipal Revenues, 2013

**British Columbia**
- User fees: 34%
- Transfers: 4%
- Other taxes: 9%
- Other revenues: 4%
- Property and related taxes: 49%

**Alberta**
- User fees: 4%
- Transfers: 18%
- Other taxes: 15%
- Other revenues: 4%
- Property and related taxes: 42%
Distribution of Municipal Revenues, 2013

**British Columbia**
- User fees: 34%
- Transfers: 4%
- Property and related taxes: 49%
- Other revenues: 4%
- Other taxes: 9%

**Ontario**
- User fees: 21%
- Transfers: 23%
- Property and related taxes: 46%
- Other revenues: 3%
- Other taxes: 7%
Distribution of Municipal Revenues, 2013

**British Columbia**
- User fees: 34%
- Transfers: 4%
- Other revenues: 4%
- Other taxes: 9%
- Property and related taxes: 49%

**Quebec**
- User fees: 21%
- Transfers: 13%
- Other revenues: 4%
- Other taxes: 2%
- Property and related taxes: 60%
Other Municipal Taxes in Selected Provinces

- Land transfer tax
- Amusement taxes
- Hotel taxes
- Poll tax
- Vehicle registration tax
- Billboard tax
- Revenue sharing e.g. fuel tax sharing
Fiscal Challenges Facing Municipalities

• Federal and provincial offloading

• Need to be internationally competitive

• High costs associated with sprawl

• Impact of economic downturn

• No diversification of revenue sources
Is There a Municipal Fiscal Imbalance?

• Most municipalities in Canada have done well on fiscal measures:

  • Size of 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 Municipal Fiscal Imbalance?

• Fiscal health may have been achieved at the expense of municipal overall health:
  • State of municipal infrastructure
  • Quality of service delivery

• Infrastructure and services are difficult to measure

• May need to look at new revenue sources
Sources of Local Taxation, Selected OECD Countries, 2012

International Experience

• More than 80% of local tax revenues from **property taxes** in Australia, New Zealand, Ireland, United Kingdom, Canada, US

• More than 80% of local tax revenues from **personal and corporate income taxes** in Sweden, Germany, Switzerland

• Sales taxes are levied mainly by cities in the US

• Mix of taxes in Spain (40% of local tax revenues from sales tax; 30% from property taxes; 20% from income tax and 10% from other)
### Taxes in Major International Cities

#### Figure 21: Taxes in Major International Cities

<table>
<thead>
<tr>
<th>Taxes</th>
<th>Toronto</th>
<th>New York</th>
<th>Paris</th>
<th>London</th>
<th>Madrid</th>
<th>Berlin</th>
<th>Tokyo</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property / Land</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Land Transfer*</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Billboard</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales / Value Added*</td>
<td>x</td>
<td></td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Personal Income*</td>
<td>x</td>
<td></td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Business Income</td>
<td>x</td>
<td>x</td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Vehicle</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Other taxes</td>
<td>18</td>
<td>5</td>
<td>3</td>
<td>16</td>
<td>12</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*In some instances, shared with senior orders of government.
Linking Taxes to Expenditures
Linking Taxes and Expenditures
Linking Taxes to Expenditures

- People want to see what they are getting for their taxes
- Linking taxes and services increases public support
- Examples of ballot initiatives in the US to pay for transit
- Public sector operates more efficiently when there is a link between expenditure and tax decisions – the Wicksellian connection
## Different Services – Different Revenue Tools

<table>
<thead>
<tr>
<th>Private</th>
<th>Public</th>
<th>Redistributive</th>
<th>Spillovers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Water</td>
<td>Police</td>
<td>Social assistance</td>
<td>Roads/transit</td>
</tr>
<tr>
<td>Sewers</td>
<td>Fire</td>
<td>Social housing</td>
<td>Culture</td>
</tr>
<tr>
<td>Garbage</td>
<td>Local parks</td>
<td></td>
<td>Social assistance</td>
</tr>
<tr>
<td>Transit</td>
<td>Street lights</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- **User fees**
- **Property tax**
- **Income tax**
- **Intergovernmental transfers**

**Sales tax transfers**
Different Infrastructure – Different Fiscal Tools

<table>
<thead>
<tr>
<th>Taxes</th>
<th>User fees</th>
<th>Borrowing</th>
</tr>
</thead>
<tbody>
<tr>
<td>short asset life</td>
<td>identifiable beneficiaries</td>
<td>large scale assets</td>
</tr>
<tr>
<td>(police cars,</td>
<td>(transit, water)</td>
<td>with long life</td>
</tr>
<tr>
<td>computers)</td>
<td></td>
<td>(roads, bridges)</td>
</tr>
</tbody>
</table>

Taxes

- Short asset life (police cars, computers)

User fees

- Identifiable beneficiaries (transit, water)

Borrowing

- Large scale assets with long life (roads, bridges)
Different Infrastructure – Different Fiscal Tools

<table>
<thead>
<tr>
<th>Development charges</th>
<th>P3s</th>
<th>Land value capture taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>growth-related costs; new development or redevelopment (water, roads, sewers)</td>
<td>large in scale; revenue stream; measurable results (toll roads)</td>
<td>increase property values (transit)</td>
</tr>
</tbody>
</table>
A Mix of Taxes

- Local governments benefit from a mix of taxes:
  - Range of expenditure responsibilities
  - Services used by commuters/visitors
  - Revenues that grow with the economy (elastic)
  - Tax distortions may offset each other
  - Increase municipal flexibility in adapting to local circumstances

- Ability to set tax rates: more responsible and more accountable to taxpayers
Revenue Options
User Fees -- Pricing Services Correctly

• How we pay for services affects our behaviour (e.g. how much water we consume, how much waste we generate)

• Pricing also affects nature, location and density of development

• Local governments need to price services and infrastructure correctly – manage demand for services and infrastructure
Property Tax – A Good Tax?

- Property is immovable
- Adequate, stable, predictable yield
- Visible/accountable
- Fair - related to benefits received; regressive?
- Residential rates not exported to other jurisdictions
- Minimum inter-municipal competition

But:
- Costly to administer -- arbitrariness of tax base
- Volatile for individual taxpayers
- Inelastic – doesn’t automatically grow with economy; changing nature of business
Property Tax – Is It Enough?

- Property tax (2010) yielded 3% or more of GDP in only three OECD countries: Canada, UK, US

- More than 2% of GDP in only four OECD countries: France, Israel, Japan, New Zealand

- Less than 1% of GDP in 22 countries

Can Property Taxes be Increased?
Revenue Hills in Toronto Area Municipalities

• Peak of the revenue hill has not been reached for residential property taxes in most municipalities (some exceptions, e.g. Oshawa)

• Closer to the peak of the revenue hill for non-residential property taxes in some municipalities but some municipalities shifting burden away from non-residential (e.g. Toronto)

Personal Income Tax

• Elastic revenue source
• Taxes commuters if levied on the basis of origin (place of employment)
• Equitable based on ability to pay and benefits received
• Administrative costs low if piggyback onto existing system

But:

• Competition with federal and provincial governments
• Potential for inter-municipal tax competition
• May increase need for equalization
General Sales Tax

- Visible on each transaction
- Elastic revenue source
- Taxes benefits enjoyed by commuters and visitors
- Competition with federal and provincial governments
- Potential for inter-municipal competition if rates set locally
Excise Taxes

- Examples: hotel occupancy, fuel, vehicle registration, parking

- Some are benefit-related
  - e.g. vehicle registration tax is related to road use and external effects such as pollution and congestion

- Can affect consumer behaviour
  - e.g. vehicle taxes reduce automobile purchases; parking taxes reduce congestion
Federal and Provincial Transfers

• Transfers are important (for equalization and spillovers) but:
  • break the link between those who benefit and those who pay
  • not stable and predictable funding (depends on resources available)
  • no incentive to use proper pricing
  • distort local decision-making
  • accountability problems with conditional transfers when two or more levels of government fund the same service
Land Value Capture Taxes

• Recoup some or all of the unearned increment in private land values arising from public investment (e.g. roads, transit, parks) or change in regulations (e.g. zoning changes)

• Examples:
  • Betterment levies or special assessments
  • Tax increment financing
  • Sale of building rights (e.g. community amenity contributions)
Development Levies

- Covers growth-related capital cost associated with new development
- Off-site infrastructure (e.g. highways, sewer lines, etc.)
- Growth pays for itself
- Impact on land use
Final Observations

• Link taxes to expenditures

• User fees should fund services where beneficiaries can be identified e.g. water, sewers, waste collection, transit, roads

• Local taxes – and possibly a range of taxes – should fund services that provide collective benefits to the local community

• Intergovernmental transfers should be used for equalization, spillovers