

a question of who does what

edited by
paul a.r. hobson and
france st-hilaire





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Foreword

City-regions are key transmission points in the global economy. They are home to skilled labour, extensive communications and transportation networks and the most flexible and innovative firms. Yet the importance of city-regions, and the extent of their role in driving the economy, is poorly recognized in Canada. Local government structures are often unwieldy, tax and transfer systems are unadapted to the form and function of modern city-region economies and government policies, in general, seldom recognize or address the particular needs of cities.

In what way has the role of city-regions evolved over the past twenty years of structural change? How should government policy be altered to reflect the importance of city-regions in the new economy? How should the division of powers among federal, provincial and local governments be reordered to better reflect current needs and realities? Are particular institutional or financial arrangements required to ensure the efficiency and effectiveness of local governments in city-regions? Must we reform local-government financing to provide a better match between local service delivery and local financing capability?

These are some of the questions the contributors to IRPP's series of monographs on City-Regions seek to answer. In the first volume, William Coffey described the profound impact the process of structural change is having on Canada's metropolitan regions and the new sectoral, occupational and spatial realities that are transforming the nature and functioning of our metropolitan

economies. In the second study, Andrew Sancton examined existing institutional arrangements in a number of Canadian city-regions and questioned both the objectives of recent municipal reforms and the conventional means of achieving them.

In the present volume, six experts on local government finance examine a broad range of issues related to urban governance and finance. The emphasis is on the appropriate role of local government in city-regions and the implications of alternative financing and expenditure arrangements in terms of efficiency, equity and accountability. The chapters include a survey of institutional and fiscal arrangements in a number of European, American and Canadian metropolitan regions; an examination of the concepts of "subsidiarity" and "enabling government" in a local government context; a case study of public finance and governance issues in the Greater Toronto Area; as well as analyses of urban infrastructure financing, pricing of local government services and the principles of local taxation.

IRPP is extremely pleased to be bringing this important work to a wider audience. A clear understanding of urban governance and finance issues is a prerequisite to improving the efficiency of local governments in Canada: reforms in this area should focus on establishing institutional structures adapted to today's economic and fiscal environment. Finally, it should be noted that the opinions expressed in this volume are the responsibility of the authors and do not necessarily reflect the views of IRPP or its Board of Directors.

Monique Jérôme-Forget President, IRPP

Introduction

Public policy analysts are seldom taken aback when new policies come to the fore. As a rule, comprehensive reforms are few and far between, and it usually takes some time for new ideas and concepts to gain acceptance and be transformed into concrete policy instruments. There are of course exceptions, but the political process is generally more conducive to incremental change than radical restructuring. So it was with great interest and some bewilderment that we watched events unfold – just as we were bringing the final editing touches to the papers contained in this volume – as the Ontario government announced, in the context of a veritable municipal reform blitz, a series of sweeping changes to the way local governments in that province work, what they do and how they finance what they do.

It all took place during "mega-week," when the Harris government released its plans to eliminate more than half of the province's school boards and take over education funding, while devolving a significant number of other programs and responsibilities to the local level – all this in the name of disentanglement, delayering and "getting government right." Property tax reform is a major element of this package, which includes the implementation of a new province-wide assessment system based on market values. This plan to completely overhaul the funding and functional responsibilities of local governments came on the heels of yet another controversial proposal to amalgamate the municipalities of Metro Toronto into one megacity.

It is not so much the issues addressed by this reform that took many by surprise – property tax reform, for example, had been on the agenda for decades – but rather the pace and the comprehensive approach to change. There are other causes for concern. For instance, some of the measures proposed – in particular, the plans for amalgamation and having municipalities share half the cost of social assistance – run counter to conventional wisdom on these issues. Also, as many critics of the plan have pointed out, the extent of the changes and their cumulative effects make it difficult to predict what the net fiscal impact might be. On the other hand, it could be argued that by proceeding with such a broad agenda, the provincial government had a unique opportunity to design a system of local governance and finance that is coherent and adapted to today's needs. Unfortunately, coherence does not seem to have been a priority in this exercise.

The Harris reforms have generated an unprecedented level of interest and debate about local government. To have issues of urban governance and municipal finance making headlines in the national media over a sustained period of time is simply unheard of in this country, where the public's attention tends to be firmly focused at the provincial and national levels.

Certainly, the strong reactions voiced within the province were to be expected. Beyond the sheer scope of the reform, some elements of the plan have sparked considerable controversy, not only because they were not anticipated, but also because the policy rationale behind them is somewhat dubious. For instance, the Toronto megacity proposal does not correspond to any of the numerous assessments of local governance in the Greater Toronto Area (GTA) undertaken in the last few years. All of these have pointed to the lack of coordination within the city-region as a fundamental problem and have emphasized the need to put in place structures or mechanisms to enable the planning and delivery of selected functions of region-wide interest on a region-wide basis. The presence of five upper-tier regional governments in Greater Toronto (Metro Toronto being one of them) is generally seen as a serious impediment in this regard – one that amalgamation of Metro Toronto municipalities in no way resolves.

The plan to off-load the full cost of social housing and half the cost of elderly care and welfare onto municipalities, in exchange for the province removing the burden of education funding from the property tax base, has also left many observers wondering. It is widely agreed that redistributive social programs should be funded from instruments that are broadly based and that reflect ability to pay. Beyond the significant disparities in municipal fiscal capacities, and the fact that local needs for such services are likely to

vary considerably from one municipality to another, the key point is that the property tax (the primary source of municipal revenue) is a wholly inappropriate base from which to finance these services.

However, the reason interest in the Harris reform has spread well beyond Ontario borders is that it touches on all the major local government issues presently on the agenda in many provinces. Indeed, a number of trends can be seen as contributing to a new awareness of things local.

As Canadian cities continue to grow and expand, the challenge is to come up with appropriate forms of local government that reflect the patterns of development and can respond adequately to evolving needs. Structural reforms involving annexation, amalgamation and/or the establishment of upper-tier local government bodies, have been the standard policy instruments to cope with urban growth and development in this country. Over the years, we have become quite familiar with the arguments in favour of such restructuring, whether it is to benefit from economies of scale and scope, to deal with intermunicipal spillovers, or to preempt destructive inter-municipal competition. Many critics argue, however, that this approach to local governance has resulted in added costs, complexity and accountability problems.² While there is growing recognition that the level of interaction and exchange among the municipal entities within a city-region creates a need for coordinated planning and the implementation of some policies on a regional scale, there is also more scepticism regarding the necessity and effectiveness of consolidation or adding a level of government in fulfilling this task, particularly when this involves trading off the benefits of smaller local government. Issues of accountability, accessibility and responsiveness to local preferences are becoming more of a concern, and the idea that services can be most efficiently and effectively delivered by the lowest level of government capable of providing them is rapidly gaining ground.

The role of local government is also brought into question by the new fiscal realities. The impact of budget cutbacks and public sector restructuring implemented by upper levels of government over the last few years has finally trickled down to the local level. The fiscal pressures have, to a great extent, created a chain reaction as one level of government undertakes measures to reduce its transfers to the next level of government. In most provinces, governments have had to cope with declining federal transfers at the same time as they were implementing their own deficit reduction plans. The resulting adjustments in provincial budgets have translated into much more than the predictable cuts in grants to local governments. The need for provincial governments to drastically reduce spending has led them to reexamine the provincial/local allocation of

funding and functional responsibilities in an effort to clarify roles and reduce the extent of intergovernmental entanglement.

The responsibilities and powers of local governments are determined by provincial legislation in this country, which means provinces are in a position to create and abolish municipalities as well as redefine their functions and powers as need be. In the past, local governments have had a significant role in funding fast-growing expenditure programs in public health and welfare, as well as education. However, in many provinces there is a significant restructuring under way in terms of the allocation of responsibilities between provincial and local governments. Although the role and importance of local governments vary greatly from province to province, as do individual provinces' responses to current fiscal pressures, some common trends emerge, notably toward a greater decentralization of "local" services such as roads, police and sewers, while responsibility for funding education and social services is being centralized - Ontario is the latest example of this, notwithstanding its proposals for social services. In some cases, provincial government takeover of education funding has been accompanied by an upward shift of some portion of the property tax. At the same time, local governments have been forced to absorb cuts in grants, while having to take on previously provincially held functions which have been downloaded without matching revenues.

Current efforts at disentanglement have been interpreted by some observers as eroding the authority and responsibilities of local governments, thus reducing their role to that of service providers. However, the outcome could be quite the opposite. There are two distinct views of local government.³ The first sees a fairly limited role for local governments as an administrative arm of the provincial government, charged with delivering provincially designated services with relatively little autonomy. The second view stresses the advantages to be derived from local governments, in terms of efficiency and effectiveness, by granting them significant autonomy in providing "local" services funded primarily from local revenues. In practice, both views are reflected in the existing models of local government in Canada, but the balance between the two is clearly shifting.

The type of role assigned to local governments has significant implications for local public finances. The trend toward greater disentanglement in provincial/municipal arrangements shifts the emphasis from more distributive considerations to issues of choice, efficiency and accountability in the delivery of local services that are essentially publicly provided private goods. The role of local government in this new context is to provide the services that residents are prepared to pay for, thus allowing for potentially substantial differences to

emerge across municipalities in response to local preferences. Efficiency and accountability are best assured by financing these services out of locally raised revenues and to the extent possible on the basis of benefits received.

The pressures on local governments can be expected to increase considerably in coming years. As they come to rely increasingly on own-source revenues to finance their operations, local governments will be expected to devise more efficient and cost-effective ways of providing the services for which they are responsible. As a result, new instruments and arrangements need to be considered. Experience in other countries indicates that there are numerous options available including privatization, partnering, inter-municipal agreements and the implementation of market-oriented and cost-recovery approaches. These new approaches, however, may require more autonomy than local governments in Canada presently enjoy. Finally, a realignment of responsibilities that results in additional funding obligations at the local level may well require broadening the range of fiscal resources available to local governments.

Given the significant changes taking place with regard to urban governance and municipal finance in this country, there are important questions that need to be addressed. There is much talk these days about bringing government closer to the people and making it more efficient and accountable. But what does it all mean? Is bigger better in terms of local government or are there advantages to having several jurisdictions competing to provide costeffective services adapted to local preferences? Which functions and responsibilities can and should be assumed at the local level? Is there a role for local governments in the financing and delivery of social services? Which institutional arrangements are best suited to cope with issues that extend beyond municipal boundaries? In a framework featuring reduced reliance on provincial grants and greater local autonomy, what are the appropriate fiscal instruments to enable local governments to fulfil their traditional functions as well as take on new roles? More generally, is there an ideal blueprint or model against which to compare and evaluate the way various cities are governed and financed? These are some of the questions IRPP asked six experts on local government finance to address in this book. The emphasis throughout is on issues of more immediate concern to metropolitan areas, focusing on the future role of local governments in city-regions and on the equity, efficiency and accountability implications of alternative financing and expenditure arrangements.

In the first chapter, Melville McMillan presents a survey of the structural and financial arrangements in place in eight city-regions in order to gain insight into how various types of arrangements influence the way and the degree to which local governments address the problems and concerns specific to this type of urban environment. The city-regions surveyed include Melbourne, Pittsburgh, Birmingham, Stockholm, Frankfurt and Canada's three largest cities – Vancouver, Toronto and Montreal. The chapter begins with a description of the structural organization of governments serving each city-region and outlines the respective expenditure responsibilities and sources of revenue of the governments involved. This description is followed by a comparative review which focuses on the important similarities and differences observed, and the reasons that these occur.

The survey reveals significant differences among the various city-regions as a result of different political systems, history, preferences and objectives. As McMillan indicates, however, while there is much structural diversity, there is also a remarkable degree of coherence in the arrangements observed, in the sense that the structure of local governance and local public finances is usually a direct function of the range of responsibilities assigned to local governments. The main point of this analysis is that the design of a regional/local government structure that is efficient, equitable and accountable must begin with a clear picture of "who does what," in terms of the provision and delivery of services within the city-region. The assignment of responsibilities determines the form of regional authority required, the type of financing arrangements that need to be put in place and the fiscal instruments that are appropriate. The extent of local government involvement in social programs is of particular importance in this regard.

McMillan also uses these observations to draw some lessons applicable to local governments in Canada in general and to provide more specific recommendations in the case of Toronto. He emphasizes the need for territorial comprehensiveness in regional governance and argues that greater equity and efficiency could be achieved through better coordination, property tax reform, disentanglement of provincial and local responsibilities to correspond with tax bases and fiscal capacities, and decentralization of local services according to the principle of subsidiarity.

In his chapter, Richard Barnett explores the application of the concepts of "subsidiarity" and "enabling government" as guiding principles in designing effective governance structures for city-regions. The principle of subsidiarity favours a decentralized organization of responsibilities, whereby a function is only assigned to a higher-level organization if it is in a "better" position to carry

out this particular function than the lower-level organization. As the author points out, the problem is defining what better means. Efficiency and transactions costs are the standard criteria used in economic analysis to address the assignment issue. Barnett argues, however, that for subsidiarity to play a significant role in the design of government structures, factors other than those narrowly related to economics will also have to be taken into account. Indeed, a broader definition of subsidiarity may even imply some tradeoffs in terms of efficiency and equity. For instance, the application of subsidiarity would call for a highly decentralized, fragmented approach to local government, one with little or no role for metropolitan government.

The primary concern of enabling government, on the other hand, is to achieve cost efficiency in the production of government services. The idea is that local government should no longer be a self-sufficient provider and producer of local services. Its role, rather, should be to "enable" a plurality of agents (e.g., private and voluntary sectors) to compete for the right to provide and/or produce local services. As Barnett demonstrates, both these concepts can have significant implications for the design of local government, particularly with respect to the role of metropolitan government, the extent of private sector involvement and the need for (and the design of) intergovernmental transfers. The author concludes, however, that until the principle of subsidiarity is more comprehensively defined, it will remain difficult to determine what constitutes the appropriate degree of subsidiarity.

Enid Slack's analysis of current public finance issues in the GTA begins with a review of the economic and political criteria for designing government structure and some background on the GTA's two-tier structure of local governance, first introduced in Metro Toronto in 1954. As she points out, the problems in the GTA today are quite similar to those that led to the establishment of an upper-tier government for Metropolitan Toronto more than four decades ago, namely political boundaries that no longer reflect the social and economic realities of the urban region, a pressing need to coordinate planning and transportation on a region-wide basis and the problem of expenditure spillovers. The existing property system is also an issue. The author points to the significant variations in effective tax rates within and among classes of property, and across municipalities in the GTA, as being both inefficient and inequitable, and she stresses the need for assessment reform.

In Slack's view, the over-taxation of commercial and industrial property in Metro Toronto compared to the rest of the GTA, combined with the lack of coordination for the delivery of services that spill over regional boundaries, threaten the economic viability of the GTA. She argues that a two-tier local governance structure is still appropriate for the region and offers significant advantages in providing the benefits of both small and large government. However, the problem with Metro Toronto as a regional government is that it no longer encompasses a large enough area to play its appropriate role. Slack favours the establishment of a new GTA government responsible for providing and financing region-wide services. Under the model of governance she proposes, existing regional governments would no longer be required and would be disbanded. She sees the Ontario government's proposal for a new province-wide uniform property assessment system as a positive move, one she considers essential for the implementation of any region-based model of governance, but particularly a two-tier system.

Issues of accountability and efficiency are central to the current debate on the role of local government. The user-pay principle applied to municipal services has particular significance for the efficient delivery of services and the promotion of accountability. Tailoring the provision of services to local preferences, while ensuring efficient decision making, requires that taxes reflect the true costs of provision. The question is to what extent do local taxes, as currently applied, correspond to the value of local services consumed or benefits received.

The property tax is generally perceived as an appropriate fiscal instrument for local governments since, in principle, it spreads the cost of locally provided services on local residents. However, whether this is in fact the case depends ultimately on the incidence of the tax. Paul Hobson argues that the property tax is not a residence-based tax, as is often assumed. Rather, it should be viewed as a source-based tax whose burden falls on owners of land and capital, and it is from this perspective that its role as an instrument of local government finance should be examined. In his chapter, Hobson compares the efficiency and equity implications of using residence-based (user charges, for instance) and source-based taxes to finance local services. He also outlines the differences in this regard between pure public goods and publicly provided private goods. His analysis indicates that with the appropriate mix of property taxes and user charges, it is possible to devise a local revenue structure that is consistent with overall efficiency goals. Moreover, he argues that the type of structure proposed may obviate the need for much of the provinciallocal equalization schemes directed at municipal property taxes, at least on efficiency grounds.

The issues involved in pricing local government services are the focus of Harry Kitchen's chapter. As he points out, most municipal services are ideally suited for market-type pricing regimes. There is an increasing tendency at the provincial and local level to impose user fees in lieu of taxes, yet there has

been relatively little empirical assessment of these. For instance, when are user fees appropriate and how should they be designed? In his assessment of existing price/tax structures for specific municipal services, Kitchen describes how current practices often deviate considerably from what is fair, efficient and accountable. The author concludes that local governments' primary (if not only) consideration in setting user fees — and property taxes for that matter — is generally to raise revenue. In his view, more effort should be devoted to the design and structure of local fiscal instruments which, in addition to their revenue generating capacity, could also play a significant role in rationing services or providing the correct signals concerning efficient levels of service provision.

The rehabilitation and expansion of infrastructure are issues of major importance for nearly every municipality. Perhaps the most significant impact of fiscal restraint on urban areas stems from cutbacks in spending on infrastructure. Some critics have argued that this has led to the deterioration of existing structures and underinvestment in new capital equipment which play a role in economic development. In the final chapter of this volume, Almos Tassonyi looks at the problems of financing urban infrastructure and, more specifically, the factors involved in replacing aging infrastructure and providing the necessary infrastructure to new residential or industrial developments. He describes existing financing arrangements and the current regulatory framework and provides an overview of trends in capital spending and finance. The author then examines the alternatives available to local governments in financing infrastructure projects. The considerations involved in the choice between long-term debt and pay-as-go schemes are discussed, as are the implications of various financing alternatives including the use of more traditional fiscal instruments (e.g., the local property tax, user charges, development charges and local improvement charges), and alternative measures such as "value capture" techniques, interjurisdictional cooperation and various forms of public-private sector partnerships. Tassonyi concludes that the current framework governing the choice of financing techniques for municipal infrastructure needs to be reexamined. He proposes some useful general guidelines to that effect, while pointing out that ultimately this framework is set at the provincial level.

Paul A.R. Hobson and France St-Hilaire

Notes

- 1. See, for example, Andrew Sancton, Governing Canada's City-Regions: Adapting Form to Function (Montreal: Institute for Research on Public Policy, 1994); Greater Toronto Area Task Force, Report of the Greater Toronto Area Task Force (Toronto: Queen's Printer for Ontario, January 1996); and the recommendations of the "Who Does What" panel chaired by David Crombie.
- 2. See Sancton, Governing Canada's City-Regions.
- 3. See Richard M. Bird, "Threading the Fiscal Labyrinth: Some Issues in Fiscal Decentralization," *National Tax Journal*, Vol. 46 (June 1993), pp. 201-21; and David M. Nowlan, "Local Taxation as an Instrument of Policy," in Frances Frisken (ed.), *The Changing Canadian Metropolis: A Public Policy Perspective*, Vol. 2 (Berkeley: Institute of Governmental Studies Press, 1994), pp. 798-841.

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