Executive Summary

Early Warning: Will Canadian Cities Compete?

A Comparative Overview of Municipal Government in Canada, the United States and Europe

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By:
Federation of
Canadian Municipalities

The Federation of Canadian Municipalities
24 Clarence Street
Ottawa, Ontario K1N 5P3

For more information please contact
Marni Cappe, Senior Policy Advisor, FCM
(613)241-5221, ext. 247

Meg Ogden, Policy Advisor, National Round Table on
the Environment and the Economy, (613)995-7519

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Introduction

This paper was prepared for the National Round Table on the Environment and the Economy to set the stage for discussions on the competitiveness of Canadian cities within a global context. Specifically, the purpose of the research is to compare legislative and fiscal powers of the U.S. and Canadian municipal governments as well as financing mechanisms for infrastructure, including a look at European examples.

The scope of this project allows for a scan of what's happening in Canada, the U.S., and Europe. The richness of information available, combined with the heightened interest in cities around the globe, suggests further research is warranted to understand fully how municipal governments work in each of the many provinces, states and countries touched by this study.

1 Legal Framework: Municipal Government in Canada

Canadian municipal governments are responsible for $43 billion of physical and social infrastructure, accounting for one in every nine dollars of government spending in Canada (1999). While the responsibilities of municipal government have changed dramatically during the past 150 years, the constitutional framework within which municipal governments must govern has not changed at all. Provinces prescribe the legal and fiscal authorities available to municipal governments, typically through a detailed list of powers.

Several provinces and territories are engaged in the debate on municipal government through recent or proposed changes in legislation. A common theme is emerging, with local governments across Canada pressing for more autonomy and more flexibility in revenue-raising authority. In some provinces such as British Columbia and Newfoundland and Labrador, proposed changes in legislation signal a shift towards the kind of locally-developed approaches municipal governments are seeking. In short, Canadian municipal governments want recognition and authority in line with their responsibilities.

2 Legal Framework: Municipal Government in the United States

Like Canada, all local governments in the United States are created by another order of government; in this case, the state. The powers granted to the states under the Constitution –and through the states to local government – are viewed as a check and balance on federal control. A distinguishing feature of local government in the U.S. is the power of the citizenry. In recent years, voters have sought to check the power of local government through referenda or ballot initiatives, (used in about half the states) and of course, direct elections.

The basic governmental structure and the basic powers of each city are set forth in a charter provided by the state. Some municipal governments in the United States derive their authorities directly from state constitutions and are governed by general law charters. However, the majority of large municipalities are governed by charters in a form of government called home rule. In this case, each city drafts and amends its own charter to establish the scope and manner of service delivery to its residents. A home rule city may regulate local matters without interference from the state legislature, provided an action is not expressly prohibited by the state.

3 Fiscal Authority: Municipal Government in Canada

The fiscal framework within which municipal governments in Canada operate is tightly controlled through provincial legislation and regulations. Although variations exist among provinces, municipal governments across Canada are quite limited in the ways they can raise and spend money. More and more, municipal governments face increasing costs and/or dwindling revenues, triggered by some or all of the following: offloading of provincial responsibilities, rapid growth, shrinking inter-governmental transfers, regulated caps on tax increases, and heightened expectations from their citizens.

Municipal revenues in Canada come from taxes, user fees, grants and transfer payments from federal or provincial governments (including payment-in-lieu-of-taxes), investments, and miscellaneous fees from licenses, amusement taxes, permits, and fines. With few exceptions, provinces have limited municipal taxing powers to property taxes, which account for the single largest source of revenue. Transfer payments and grants, contributing 18.7% of total municipal revenue, are significantly below averages recorded in the United States (27%) and Europe (31%).

4 Fiscal Authority: Municipal Government in the United States

Municipal governments in the United States operate within a more permissive fiscal framework than their Canadian counterparts. Like Canada, municipal governments in the U.S. rely on property taxes as the single largest revenue source. Unlike Canada, municipal governments in the U.S. draw from a much wider array of financing mechanisms. On the other hand, municipal governments in the U.S. are more reliant on user fees and sales taxes, with a small number of states allowing individual local income tax.

One need only compare Census data from 1996 to appreciate the difference:

1996	Canada	U.S.
Property taxes as a share of all municipal revenue	49.5%	21%
Other taxes as a share of municipal revenue	1%	13.5%
User fees as a share	20.2%	32.6%

Other than wider taxing powers, municipal governments in the U.S. enjoy additional advantages in their power to provide tax incentives to attract private sector investment. At the same time, financial incentives can be a powerful tool to achieve municipal objectives for development and redevelopment.

Without doubt, the fiscal toolkit available to municipal governments in the U.S. offers more choices than those available to their Canadian counterparts. Nonetheless, current debates on urban issues in the United States appear equally focused on matters financial.

The fiscal issues in the United States are not simply about the sources of revenue available to municipal government, but more specifically, about the failure of the property tax base to support inner cities. Increasing reliance on other forms of taxation, such as sales taxes or commuter taxes, stems in part from the need to obtain revenue from non-resident beneficiaries of municipal government service. This preoccupation may well be the next big issue for Canada's largest urban areas. The Federation of Canadian Municipalities, in its March 2001 Quality of Life report, emphasized the growing income gap between our wealthiest and poorest urban citizens.

MUNICIPAL AUTHORITY: USA and CANADA

	USA	CANADA
Property tax	✔	✔
Sales tax	✔	
Hotel/motel tax	✔	*
Business tax	✔	
Fuel tax	✔	*
License fees	✔	✔
Income tax: individual and corporate	✔	
Development charges	✔	✔
Tax-exempt municipal bonds	✔	
Tax incentives	✔	
Grants to corporations	✔	
Borrow money	✔	✔

**indicates rare instances of this type of authority*

> "The main concern of municipal governments is their capacity to finance, predictably and responsibly, the increasing functions and responsibilities they are being given, either by statute or public expectation. Municipal governments must change the way they finance their operations so that they can meet their growing responsibilities ensure accountability, and develop their capacity to play an even more positive, productive and responsive role in Canada's political system."
>
> *Federation of Canadian Municipalities*

5 Comparative Overview of Financing Mechanisms for Infrastructure in Canada, the United States, and Europe

What Canada is Doing

A scan of municipal budget presentations across Canada reveals a common and growing preoccupation with how to finance infrastructure. Whether the city is fast-growing, like Ottawa or Calgary, or stable like Winnipeg, municipal officials emphasize the need for funding solutions to allow for such basic improvements as: more roads, better transit, modern water systems, and rehabilitated sewers. For the most part, municipal governments are the majority or sole funder of these major public works.

Once a foundation for funding large capital projects, infrastructure grants in Canada are now too small and too sporadic to provide an effective and reliable revenue source. Building on the 1994 Infrastructure Program, the Government of Canada launched a new version in 1999 with $2.1 billion for municipal infrastructure. Priority funding is set aside for "green municipal infrastructure". In addition, several provinces have specific programs to support infrastructure projects.

What the U.S. is Doing

Significant investment in U.S. cities during the past decade has been stimulated in large measure by federal and state programs that leverage private sector investment in infrastructure. On average, more than $263 million per year has been invested in the downtowns and waterfronts of ten U.S. cities during the past decade; roughly five time the rate of investment in the City of Toronto. Direct contributions by local governments come from the types of funding mechanisms described for Canadian municipal governments: user fees, general revenue, borrowing, etc. However, U.S. municipal governments take advantage of a much wider range of flexible financing arrangements to achieve strong public-private partnerships. These include, among others, tax abatements, tax-exempt municipal bonds, local sales tax and income tax credits or exemptions, access to state revolving funds for clean water, and state infrastructure banks for transportation.

Financing mechanisms available to Canadian municipal governments generally include:

General Financing – generated through tax revenues and may include borrowing for tax-supported capital expenditures

- **Reserves – funds transferred from current operations of the municipality or funds set aside for specific capital projects**
- **Debt issuance – funds borrowed for infra structure projects generally in accordance with borrowing limits set by the province.**
- **Development charges – charges for growth-related capital costs**
- **Developer funding – capital expenditures funded by private sector developers and are usually cost-shared**
- **Local improvements and surcharges – funds collected directly from benefitting users and used for targetted projects in communities**
- **User fees – monies collected as services are consumed**
- **Grants – provincial or federal commitment of funds for specific capital purposes**

The single largest infrastructure investment program in the U.S is the Transportation Equity Act for the 21st Century (TEA-21). Innovation is a hallmark of the TEA-21 legislation, fostering ways to allow for flexibility and leveraging of federal resources for private sector participation. State infrastructure banks, direct credit assistance, joint development of transit assets are examples.

Investments in water and wastewater infrastructure in the U.S. are principally achieved through state clean water and drinking water loan programs or revolving funds. Traditional grant programs of the 70s and 80s have been replaced, effecting a shift to local governments and private funding sources. Because the new loan program offers long-term funding for water quality and wastewater construction activities, local governments and states have generally supported the change.

A variety of flexible tools are available, allowing states to issue bonds, and offer loans for water and wastewater systems at below-market interest rates. Assistance to disadvantaged communities may come in the form of negative interest rate loans, or principal forgiveness.

New York has succeeded in leveraging $460 million in loans while receiving only $200 million in federal grants for water infrastructure.

Infrastructure is more than just pipes, roads, and buses. In the United States, more than 250 funding programs are available to finance urban redevelopment and affordable housing through the Department of Housing and Urban Development. One of the largest is the Community Development Block Grant, including a series of initiatives such as brownfields and other tax incentives, loan guarantees, and funds earmarked for small cities.

What Europe is Doing

Much like Canada and the United States, infrastructure investment in Europe comes from a variety of sources, including national and local governments, and private-public partnerships. Recent trends in many countries have seen more decentralisation of service provision, and a breaking away from a "top-down" model of government. Growing recognition of the importance of cities as centres of value creation and employment underpin this trend.

Investment in European cities is significantly enhanced by European funds aimed at reducing regional disparities within the European Union (EU). Generally, all countries in the EU include regions or cities where need for EU funding can be demonstrated. The primary vehicle for infrastructure funding is the European Regional Development Fund (ERDF) whose 2000-2006 budget of Euro 195 billion (approximately $175 billion US) accounts for fully one-third of the EU budget. Projects eligible for ERDF funding must demonstrate the availability of matching funds from within the host country (whether from the local or national government, private sector, Lottery funds etc.).

Just over half of ERDF funding is targetted for transport in 2000. In general, national contributions to public transportation are significant. Within the European G-7 countries, national governments fund 15-30% of all operating costs, and 30-100% for capital expenditures on public transportation.

The six-year TEA-21 program, initiated in 1999, allocated over $100 billion for urban transportation. By contrast, the Government of Canada's six-year infrastructure program allocates $2 billion CDN ($1.2b US) for all types of infrastructure – water and wastewater systems, transportation, housing, etc.

Just under one-third of the ERDF funding on infrastructure is dedicated to environment and water projects. The European Union has placed special emphasis on environmental standards, and in many cases, European funding supports multiple environmental objectives. Creative partnerships support large-scale environmental projects in European countries. Anchored by substantial funding from the EU, environmental infrastructure projects can attract funding from private partners, non-government organizations, and of course, national and local governments.

Above all, European funding to municipal governments supports sustainable development in the broadest sense: environmental, social, and economic. The Second Report on Economic and Social Cohesion to the European Commission underscores the importance of investment in cities. The report finds that the ERDF and other European funds increased the competitiveness and productivity of urban regions by supporting investment in infrastructure and human capital. Assistance is an effective means of mobilizing private capital as well as loans, especially from the European Investment Bank.

One of the innovative financing techniques in France is the national Transport Contribution tax – a special tax which finances the investment and operation of urban public transport in cities with a population of more than 30,000. The tax (called the Versement de Transport) is paid to the local Urban Transport Authority by all employers with more than nine employees and is fixed at 1.75% of wage.

6 Conclusion

Research has uncovered a treasure chest of fiscal tools and national and supra-national grants available to municipal governments in the United States and Europe. Municipal governments in Canada are heavily reliant on locally-generated revenues, have fewer levers to attract investment, and scant access to federal and provincial funds. What is clear is that U.S. and European municipal governments benefit from mechanisms that are not typically available, or not as widely available, to their Canadian counterparts. For example:

- legal authority for local self-government, available to U.S. municipal governments through Home Rule Charters
- fiscal authority to engage in public-private partnerships through such mechanisms as municipal permission to hold a mortgage
- access to growth taxes, such as a sales tax, commonly used in the U.S.; or local income taxes, as imposed in Europe and in the U.S.
- opportunities to leverage private sector investment through direct tax incentives
- access to permanent lending programs for infrastructure, such as infrastructure banks and revolving funds