September 7, 2018

Memorandum to the Standing Committee on Municipal Finance and Intergovernmental Arrangements

DECISION MEMO: Election 2019 – Principles for Fiscal Tools Advocacy

EXECUTIVE SUMMARY

This memorandum expands on the 2018-2019 Policy and Advocacy Priorities memo regarding fiscal tools and proposes a set of principles to guide FCM staff's political engagement with the federal political parties on the need for new fiscal tools for local governments.

DECISION HISTORY

At the September 2017 Board of Directors Meeting, this Committee adopted policy development on municipal finance and municipal autonomy as one of its 2017-18 policy and advocacy priorities.

BACKGROUND

- In 2001, the federal government introduced a new framework to provide municipalities with payments in lieu of taxes on federal properties. FCM intervened in two cases at the Supreme Court of Canada in 2010 and 2012 that favoured the municipal position.
- In 2002, FCM called for the transfer of a portion of the federal gas tax to municipal governments to provide stable, predictable funding and the five-year Gas Tax Fund was introduced in 2005. In response to FCM's call for an ongoing federal revenue-sharing arrangement, the federal government legislated a permanent annual investment of $2 billion in municipal infrastructure through the Gas Tax Fund in Budget 2011 and a two percent index was applied to protect the Fund against inflation in 2012.
- In 2004, FCM played a role in the federal government increasing the GST/federal component of the HST rebate for municipal governments to 100%.
- FCM's work leading into Election 2015 and advocacy on the implementation of commitments has shaped the federal landscape with transformative gains for municipalities: Canada's first National Housing Strategy, a 12-year $180-billion federal infrastructure plan, and a strengthened seat at the federal table.
- FCM's Budget 2018 pre-budget submission called for new formalized federal-municipal partnerships and the exploration of permanent new tools to support progress towards shared objective.
- FCM's Budget 2019 written submission for pre-budget consultations called for modernized commitments, discussion on new tools for local governments and a stronger federal-municipal partnership.

ANALYSIS

The current fiscal and legislative framework in which municipalities operate is outdated. It hasn't changed since it was created and does not reflect the modern and increasingly necessary reality of the role of cities and communities in Canada. Local governments are increasingly called upon to deliver on modern, national priorities, playing a leading role on issues ranging

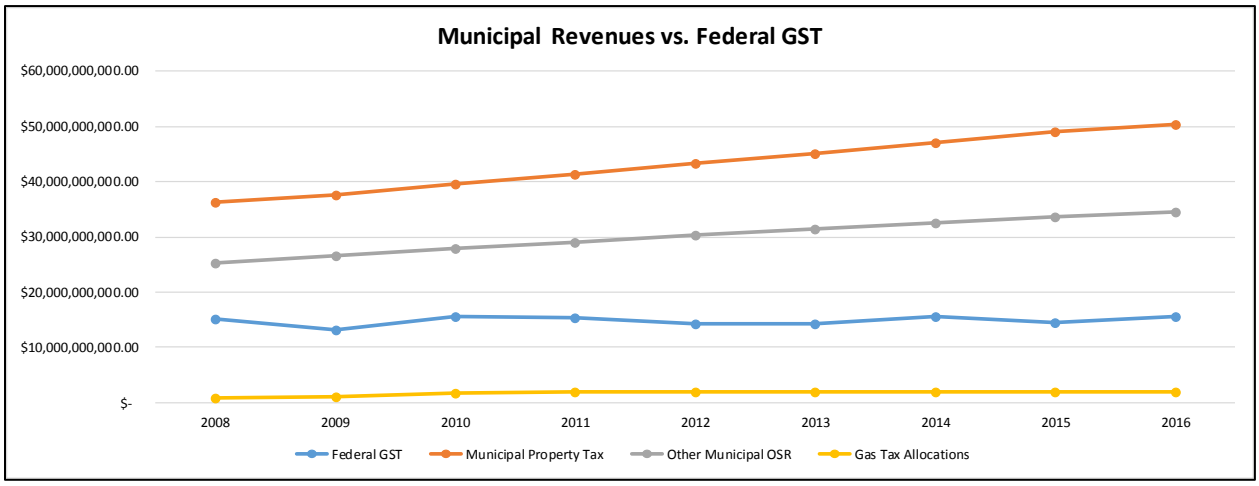
from tackling gun violence and regulating legalized cannabis, to addressing the opioid crisis and helping newcomers thrive in our communities. A critical component of FCM's Election 2019 platform is looking to address this gap, through new fiscal tools and strengthened federal-municipal partnerships.

The existing fiscal tools available to local governments – property taxes and user fees – have significant limitations in the context of growing municipal responsibilities. And because local governments generally cannot run deficits, they have learned to squeeze maximum value from every dollar and every tool available. As of 2016, municipal governments collected a 10.3% share of all taxes at a national level – a slight increase from 9.7% in 2008. This compares to 45.4% collected by the provincial/territorial governments and 44.3% collected by the federal government. As of 2016, municipal revenue sources were distributed as follows, which has not changed substantively since 2008:

- Property tax – 48%
- Government transfers (federal and provincial) – 19%
- User fees – 22%
- Goods and services – 8%
- Other revenues – 3%

Existing federal programs, including the permanent and indexed Gas Tax Fund (GTF), the 100 percent GST rebate and payments in lieu of taxes, are critically important for local governments, but do not fully meet the needed investment in new infrastructure, infrastructure renewal and other core public services delivered at the local level. An analysis of municipal own source revenue versus the GTF and federal GST (see Figure 1 below) demonstrates that municipal own source revenue increased at a significantly faster pace than GST since 2008 – 38% versus 3% (not adjusted for inflation) – meaning local governments have had to rely more heavily on these tools to meet growing need. And while the Gas Tax Fund also increased substantially, it remains a small component of municipal revenue – 1.3% in 2008 and 1.9% in 2016 (where overall government transfers were 19% both years).

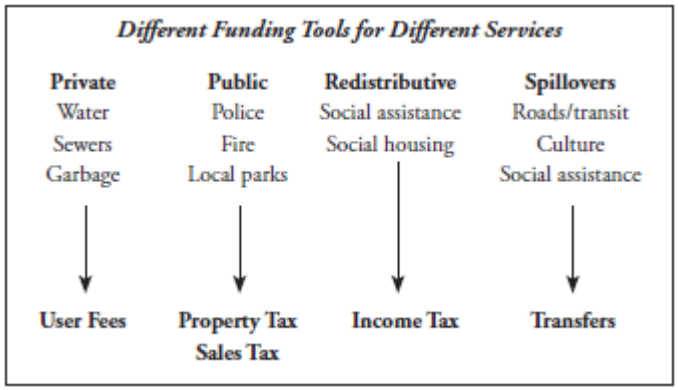
Figure 1



Around the world in other countries of the Organization for Economic Co-operation and Development (OECD), municipalities have more diverse and flexible options in their fiscal toolboxes. Of the 34 countries, 21 have income tax as a source of local tax revenue and 28 have sales tax as a source of local tax revenue. In nearly half the countries, 15, local taxes

make up a higher percentage of all taxes than Canada. This includes two other federal countries, Switzerland and the United States, where local taxes were 15.2% and 14.5% of all taxes, respectively, in 2013.[1]

Figure 2



Leading researchers in local government finance and governance stress the importance of linking the appropriate types of taxes/revenues to specific types of expenditures. Municipal finance expert Enid Slack from the Institute on Municipal Finance and Governance assigns an optimal funding tool to different services provided at the local level. This model identifies direct user fees as the most appropriate funding tool for "private goods"; income taxes for services that tackle inequity; and transfers (from federal and/or provincial/territorial governments to local governments) for services with broad spillover effects (see Figure 2)[2]. In the existing fiscal framework, local governments are overly reliant on user fees and property tax revenues and do not have access to most appropriate funding tools for the delivery of services like social housing and roads/transit that are best funded through income taxes or transfers.

As noted in the Priorities memo, FCM has already initiated research on municipal fiscal tools and intends to engage external consultants to inform our analysis of potential options for a federal commitment to improving the fiscal tools available to local governments. Options being considered for analysis include a major expansion of the Gas Tax Fund or a portion of the existing federal Goods and Services Tax. In engaging in this conversation, however, it is necessary to define the core design elements that any potential fiscal tool must meet to respond to the needs of local governments.

Staff recommend the following principles to guide discussions with federal parties ahead of Election 2019, building on FCM's historical advocacy and policy successes, most notably the permanent and indexed federal Gas Tax Fund:

1. **Link to economic growth** – Any new fiscal tool should be designed in a manner that ties the future value of the tool to economic growth. This has been an objective of provincial-level efforts in Saskatchewan, Manitoba and Quebec to reform the fiscal relationship through municipal access to a portion of provincial sales taxes.

2. **Broad eligibility –** The types of municipal projects eligible for funding through a new fiscal tool should be defined in very broad terms based on the full range of municipally defined priorities. Ideally, this would include both capital and operating costs and important cost drivers like financing costs and land acquisition usually deemed as ineligible for federal support under existing federal infrastructure programs.

---

[1] New Tax Sources for Canada's Largest Cities: What are the Options? Harry Kitchen and Enid Slack. Institute on Municipal Finance and Governance. November 2016.
[2] ibid

3. **Predictable allocation to local governments –** As with the federal Gas Tax Fund and the transit portion of the Investing in Canada Plan, a new fiscal tool should be allocated to all municipalities on a predictable and transparent basis.

4. **Base plus per capita allocations to provinces/territories** – As with the federal Gas Tax Fund and all recent federal infrastructure programs, the allocation of funding to provinces/territories (after which funding is allocated to municipalities) should adopt a base plus per capita approach to ensure smaller jurisdictions benefit from a minimum level of funding.

5. **Long-term sustainability** – Similar to the federal Gas Tax Fund, any new fiscal tool should be introduced on a long-term and predictable basis and implemented as a statutory transfer payment rather than a contribution program subject to annual appropriations by Parliament.

POLITICAL CONSIDERATIONS

See Election 2019 memo and presentation to the Committee of the Whole.

RECOMMENDATION

It is recommended that the Standing Committee on Municipal Finance and Intergovernmental Arrangements:

1) Direct staff to advance the following principles in their engagement with federal political parties on new fiscal tools:
   a) Link to economic growth;
   b) Broad eligibility;
   c) Predictable allocation to local governments;
   d) Base plus per capita allocations to provinces/territories; and
   e) Long-term sustainability.

2) Receive this report.

Jen Arntfield Manager, Policy and Research	Daniel Rubinstein Director, Policy and Research