Under Pressure:

Ontario's Municipalities and the Case for a New Fiscal Arrangement

AMO Submission to the Standing Committee on Finance and Economic Affairs

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Association of Municipalities of Ontario

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INTRODUCTION

Ontario's municipalities are the foundation of our local, provincial and national economies. Yet, growing responsibilities and shrinking resources are stifling our communities, large and small. Provincial investments in local communities have been made, and are appreciated, but a great deal more needs to be done if Ontario communities are to be livable, sustainable, and competitive in the national and global marketplace.

The Ontario government faces a number of serious fiscal restraints that cannot be ignored, and the Ontario government has set a number of priority goals it wishes to achieve – some of which are evident over the course of the last three provincial budgets: deficit reduction; investments in health care; and investments in education. Each of these is a laudable goal and has merit in its own right.

However, if there was to be an overriding theme for municipal government regarding this year's Provincial Budget, AMO would propose that it be the urgent need to address the provincial-municipal fiscal imbalance and resulting municipal infrastructure deficit.

The increasingly unsustainable fiscal situation for municipalities is particularly evident in the infrastructure deficit that we currently face. The Canadian Council of Professional Engineers has estimated the municipal infrastructure gap in Canada to be $60 billion, growing at $2 billion a year[1]. The Ontario Ministry of Public Infrastructure Renewal itself estimates a total infrastructure gap for Ontario of $100 billion. Irrespective of the exact estimates of the infrastructure gap, it exists, and to address it, municipalities need their fair share of the money sent to the provincial treasury each year.

Successive provincial governments have created fiscal crises for Ontario's municipalities by downloading responsibilities without adequate funding and without creating room for municipal government to fund these services through progressive taxes. The previous provincial government also eliminated over $600 million year in unconditional grants to municipalities and eliminated provincial funding for roads.

The bottom line is clear – municipalities need to be free to use the municipal property tax base for their own services and capital expenditures.

[1] FCM Policy Priorities: Key Facts and Figures

PROPERTY TAXES: AN ONTARIO MUNICIPAL PERSPECTIVE

Canada is the world champion of reliance on property taxation as revenue. At the local level, on national average, property taxes accounted for 40.4% of total revenues in 2004/05. This share has remained stable during the last 15 years, peaking at 43.4% in 1997/98.[2] In Ontario specifically, in 2004 property taxes accounted for almost 50% of total local revenue (see Appendix “A”), with the residential property class the largest contributor.

Ontario and Alberta have the highest spending local governments, followed closely by Quebec, Nova Scotia, Manitoba and Saskatchewan[3]. It is important to identify, however, that most of the spending differences among the provinces are a result of differing sets of spending responsibilities. For example, each province has its own formula for funding education, health and social services at the local level.

In Ontario, property taxes consist of two elements: the taxes for municipal services (e.g., services to property – for example, roads, police and fire protection – as well as services to people – such as social assistance and social housing); and education taxes. Municipal councils set the tax rates for municipal services and the Ontario Ministry of Finance sets the rates for education.

In Ontario, 26% (2004) of all Ontario municipal operating expenditures goes toward funding social services and housing expenses and another 5% goes to health. While net costs are set by “conditional grants” reflecting the provincial share of these programs, the result is a massive municipal subsidy to the Province. (see Appendix “A”). No other jurisdiction in North America funds health and social services this way, and no other jurisdiction has chosen to follow Ontario’s download example.

Gross Domestic Product and Municipal Fiscal Health

The federal government of Canada defines “Gross Domestic Product (GDP)” as “…the unduplicated value of all goods and services produced in a year within Canada’s borders measured at market prices”.

GDP is the standard measure of the overall size of the economy. The growth in real GDP – that is, GDP after inflation has been taken into account – is often used as an indicator of the general health of the economy.

Total property and wealth taxes in the Canadian economy represented 4.1% of Canada's gross domestic product (GDP) in 1993, well above levels found in any other

[2] Statistics Canada, The Daily: Government finance: Revenue, expenditure and surplus, June 16, 2005.

[3] Source: Organization for Economic Cooperation and Development (OECD), Revenue Statistics of OECD Member Countries, 1965-1993 (CFIB, Research and Reports).

developed countries. In comparison, property taxes in the U.S. represented 3.3% of its GDP, while taxes in other major countries averaged 1.0% to 3.1% of total economic output[4].

As the Organization for Economic Cooperation and Development (OECD) chart shows (see Appendix "B"), Canada has the second highest reliance on property taxes among the OECD countries. And, Ontario, as a jurisdiction, has the highest dependency of all.

This reliance on the municipal property tax base to fund human/income redistributive services has distorted the tax burden in Ontario by shifting costs from income tax to property tax without regard to the taxpayers' ability to pay. It has also contributed to the municipal infrastructure "gap" – where the monies needed to pay for growth planning as well as maintenance of aging infrastructure outstrip available revenues.

Without question, as the main source of revenue for municipal government in Ontario, access to the municipal property tax base to address local needs is strained. Reducing the Province's over-dependency on municipal property taxes is the only way to fix the problem and alleviate the fiscal pressures at the local level.

THE MUNICIPAL CONTEXT AND THE FISCAL IMBALANCE

The expectation that provincially-mandated services could be funded through the municipal property tax base has proven unsustainable.

It has created a fiscal imbalance with municipalities in excess of $3 billion a year and growing, that has prevented municipalities from reaching their full potential as drivers of economic development and challenged the basic municipal infrastructure that underpins the quality of our lives as citizens: our reliance on clean, safe drinking water and wastewater systems, solid waste management and recycling programs, well maintained streets and roads, effective rapid transit, and the recreation and cultural infrastructure that is a key factor of healthy, vibrant communities.

Municipalities are not alone in their perspective on the download crisis across the province. Credible organizations such as the Toronto Board of Trade, TD Economics, and a host of academic experts and taxpayer groups agree that the current provincial-municipal fiscal arrangement must be rebalanced.

Deferred Infrastructure Investment

The rehabilitation of municipal roads and bridges plays an important role in moving people and goods across the province, which in turn contributes to economic development in key sectors such as agriculture, tourism and trade.

[4] Ibid.

Rural and Northern communities in particular depend on modern and well-maintained infrastructure in order to grow and prosper and to move products and resources to market safely and effectively. Residents and industries in our communities need access to clean, safe drinking water. Effective wastewater treatment capacity is needed to protect Ontario's precious water resources. Additional infrastructure is needed to promote better health outcomes.

However, because municipalities have been subsidizing provincial health and social services programs to the tune $3 billion a year since the previous government's download, billions have been diverted from municipal infrastructure investment, including deferred maintenance for roads and bridges. Consequently, municipal own-source revenues (e.g. property taxes) that should be invested in municipal infrastructure are being sent to the provincial treasury. The result has been a steady deterioration in municipal infrastructure of all types.

Canada's Municipal Rural Infrastructure Fund (COMRIF) funding in Ontario – which includes about $300 million in provincial funding over 5 years (as well as $300 million from the feds and $300 million from participating municipalities) – has resulted in about 300 applications for each of the three intakes

In the first two intakes of applications for COMRIF, road and bridge projects were in the majority (across all three intakes of applications for COMRIF, over 70% of requests for funding were for roads and bridges). In Intake Three alone, total eligible requests across 298 applications exceeded $1 billion.

The high number of applications indicates continued municipal interest in obtaining assistance for infrastructure. The demand has demonstrated to be enormous and obviously significantly exceeds the availability of funds.

In reality, Ontario's municipalities need a stable, reliable, permanent funding stream to assist with infrastructure investment.

Gas Tax

The Government has allocated a permanent 2 cents a litre for municipal transit – just over $300 million a year. That goes to about 80 municipalities operating public transit and community transit systems. This is permanent, sustainable funding – and we congratulate the Ontario Government for this commitment. Unfortunately though, this gas tax funding is limited to municipal transit, based on a formula of transit ridership/population.

There is no comparable dedicated funding for roads and bridges.

Rural Ontario's roads and bridges are its' transit systems. People pay the same provincial gas tax in rural Ontario as those in our cities and towns. They deserve to benefit from a transfer in gas tax revenues as much as people served by transit systems. It is a question of fairness and equity. In more remote areas of the province, the cost of maintaining rural road systems, including former provincial highways that were downloaded in the mid-1990s[5], has become the sole responsibility of local property taxpayers in these areas.

The state of rural road systems is not improving. Like other forms of municipal infrastructure, deferral of investment in roads and bridges due to lack of resources has resulted in a serious infrastructure deficit that undermines Ontario's transportation network.

It has to be in the interest of all Ontarians, including those who have access to local transit systems, to ensure that rural roads are adequately funded. AMO strongly encourages the provincial government to dedicate another 2 cents a litre of provincial gas tax funding (equivalent to approximately $300 million) to support road and bridge investment in rural and northern communities.

The Provincial-Municipal Fiscal and Service Delivery Review

Municipalities have long called for an opportunity to conduct a public review of this relationship, with representation from the provincial government, municipalities, and input from other key stakeholders. The Province has now agreed to work with AMO on that plan. In his address to the 2006 AMO Conference, Premier McGuinty announced that a joint Provincial-Municipal Fiscal and Service Delivery Review will be conducted over the next 18 months by both orders of government, concluding in the release of a public report in the spring of 2008.

The broad-based review will include the funding and delivery of provincial health and social services programs as well as other important matters. The review will examine ways to restructure the existing fiscal architecture to give all Ontarians, regardless of where they live, access to programs and services necessary to succeed in an increasingly competitive global economy.

AMO welcomes this opportunity to begin addressing the unsustainable provincial-municipal fiscal imbalance in a principled manner that will identify a new fiscal and service delivery partnership for the 21st Century.

[5] In Eastern Ontario alone, the responsibility for maintaining over 40% of former provincial highways was transferred to the Upper Tier Municipalities (UTM).

OTHER ISSUES OF SPECIFIC CONCERN

Crown Lands

Crown lands generate no revenues for local or county municipal governments. Crown lands on the other hand, generate substantial revenues for the Province of Ontario. These revenues come from land use permits, park usage fees, recreational trails, timber cutting rights, aggregate use permits, plus spin-off revenues such as fuel tax, licensing and sales tax. For example, it is estimated that stumpage fees alone generate over $100 million annually for the Province.

In addition, many provincial ministries use municipal roadways in order to carry out their mandates with Crown lands. They include the Ministry of Natural Resources for fish, wildlife, land management, and fire protection of these valuable resources.

Municipalities are required to operate and maintain a wide range of services including roads and bridges, ambulance, fire, and police that support activities in Crown lands. In Eastern Ontario alone, Crown lands cover over 11,000 square kilometres (i.e., 2 million acres) of land that produce no revenues for either counties or local municipalities.

The cost of these municipal services is borne entirely by municipal property taxpayers outside of Crown land. From a point of fairness and equity, it is important that this cost be shared with the Province of Ontario. A provincial payment-in-lieu program for all Crown land based on application of local and county residential tax rates would assist in reducing this burden.

Slower Growth

Most experts predict slower growth for the province in the short term. On average, private-sector forecasters expect Ontario's real gross domestic product (GDP) growth to be 1.7% in 2006, 2.1% in 2007 and 3% in 2008. The Minister of Finance himself now projects real GDP growth of 1.6% in Ontario in 2006 – down from 2.3% projected in the 2006 Budget.

Certain communities across Ontario continue to experience slower new growth particularly in the commercial and industrial sectors. There is, in fact, a great deal of downward pressure in many parts of the province as a result of retrenchments in the forest sector and related industries. The result is that, in slower growth areas, with commercial and industrial assessments accounting for a small portion of the total assessment, residential property taxpayers continue to shoulder the weight of the total tax burden.

In communities across Ontario where there is stagnant growth of population, including most particularly rural and northern communities outside of large urban centres, there are unique challenges. Without sufficient movement of population into these areas, the municipal property tax base may be insufficient to support projects that contribute toward economic development and growth. This may leave municipal leaders unable to complete strategic planning for their communities, and frustrated by a lack of certainty given application-based provincial grants and the ever-changing criteria such programs use to judge the outcome of these applications.

Municipally-funded Property Tax Discounts

In addition to those provincial health and social services programs that remain on the municipal property tax base, there remains the issue of provincial programs designed to meet provincial economic and environmental policy objectives, still funded mainly by municipalities via the municipal property tax base: namely, the "Farmland Tax Program" and the "Managed Forest Tax Incentive Program".

Under the then provincial government's property tax reform initiative in 1997, tax rebate programs for farmland and managed forests were eliminated after the 1997 tax year. The new policy effectively changed what were provincially-funded tax rebates into municipally-funded property tax discounts, that is; municipal tax expenditures.

Managed Forest Tax Incentive Program (MFTIP)

MFTIP is a voluntary program administered by the Ministry of Natural Resources that provides lower property taxes to participating landowners that agree to conserve and actively manage their forests. It provides a 75% discount on property taxes to landowners who agree to manage their forests, including commercial forestry operations – shifting the property tax burden to others in the community.

While the total costs of this program are not extraordinary, the principle of forcing municipalities to subsidize a provincial forest management program is bizarre and unaccountable.

Farmland Taxation Policy

Starting January 1998, the "Farm Tax Rebate Program" was replaced by a new "Farmland Taxation Policy" for farm properties administered by the Ministry of Agriculture and Food.

Under the existing provincial tax policy, farm and farm woodlot properties satisfying the eligibility requirements are taxed at only 25% of the municipal residential tax rate. The result is a shift to higher property taxes for other residents.

When the cost of this program was downloaded by the previous provincial government, the cost to municipalities was estimated at $165 million a year for about $30 billion worth of farm land in Ontario.

In 2007, the Province's Ontario Municipal Partnership Fund (OMPF) will provide only $49 million in total offsets for these two programs.

AMO has long advocated on behalf of rural Ontarians and we are acutely aware of the importance of a sustainable agriculture industry and of environment conservation efforts. However, provincial programs based on municipal tax expenditures are flawed in principle and in practice. To this day, there remains no good public policy rationale for these programs to be funded out of the municipal property tax base.

Development Charges

Development creates jobs, and growth swells provincial income tax revenues. Most communities welcome growth, and they welcome new residents and business investment. We all benefit from competitive development costs that encourage growth and investment in Ontario's economy.

But in Ontario, development brings added net costs for municipalities.

In 1997, the previous government amended Ontario's development charges legislation to require municipalities to subsidize growth. Until then, development charges legislation was based on the principle that "growth should pay its own way".

The changes were dramatic, costly to municipalities and unfair to property tax payers. The changes reduced the developers' contribution to services such as water and sewer infrastructure and transit, and eliminated any responsibility for the costs of additional waste management capacity to meet the demands of growth.

The changes also meant that developers would no longer be required to contribute to services that are critically important to the quality of life in our communities, such a parks, hospitals, recreation and cultural facilities. It has prevented municipalities from charging new developments their share of transit service level improvements or the cost of higher order transit investments.

When these changes were imposed on municipalities in 1997, the government of the day assured Ontarians that they would lead to lower housing prices. The result has been reduced access to services in the community and higher property taxes.

In its election platform, this government committed to ensuring that developers "absorb their fair share of the costs of new growth." The review of the *Development Charges Act, 1997,* has not yet happened.

AMO strongly believes that development charges are an important opportunity to promote development by recouping some of the costs of new infrastructure. It confounds our business by continuing to ask municipalities to subsidize development and by asking municipal property tax payers to continue to pay for growth. AMO encourages the Province to work toward meaningful legislative change that will promote sustainable growth and development for all local communities across Ontario. Restoring balance to the *Development Charges Act* will help make Ontario's communities sustainable once again, and will cost the provincial treasury nothing.

CONCLUSIONS

Our fiscal arrangements must promote prosperity for all of Ontario.

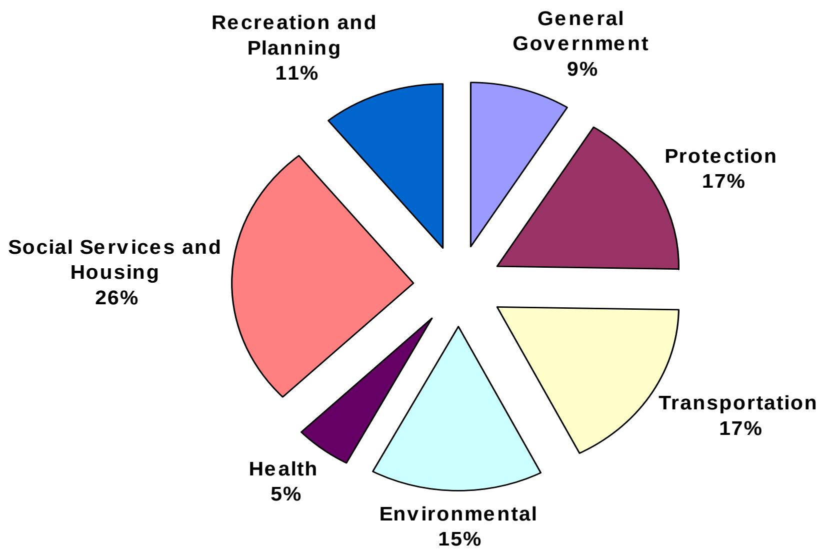
Ontario's municipal partners are committed to strong communities, a strong Ontario, and a strong Canada. The upcoming Provincial Budget is an opportunity for the Province to strengthen its commitments to municipal government, and contribute toward an Ontario where local communities are livable, sustainable, and a solid foundation for the national economy.

While the municipal sector has conceded that the provincial-municipal fiscal problem cannot be solved overnight, given the Province's fiscal situation, it has asked the Province to commit to working with AMO on a plan to restore municipal fiscal sustainability – we are pleased that the Ontario government has agreed to work with its municipal partners toward such a plan.

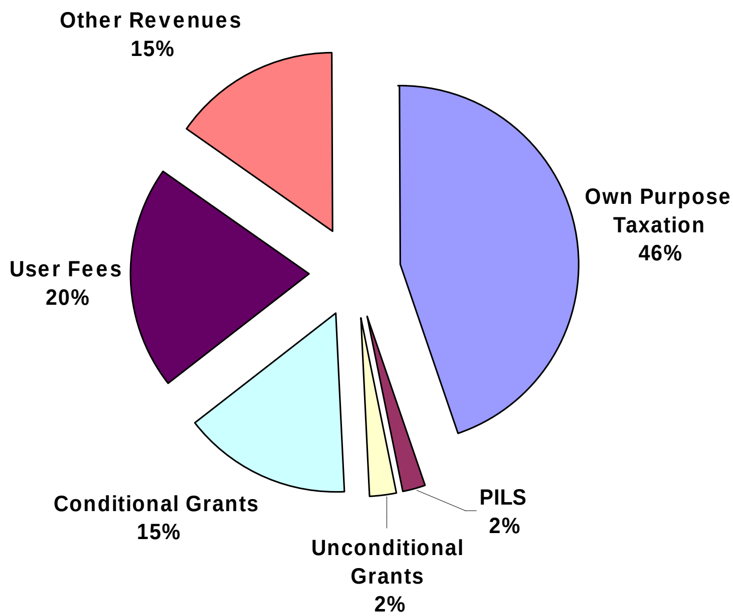
Municipal governments accept that the fiscal imbalance will be addressed in a way that's fair and that will allow for the ongoing generation of wealth and prosperity for the benefit of Ontario's communities and its taxpayers.

<u>Appendix A:</u> Ontario Municipal Operating Expenditures & Revenues (2004)

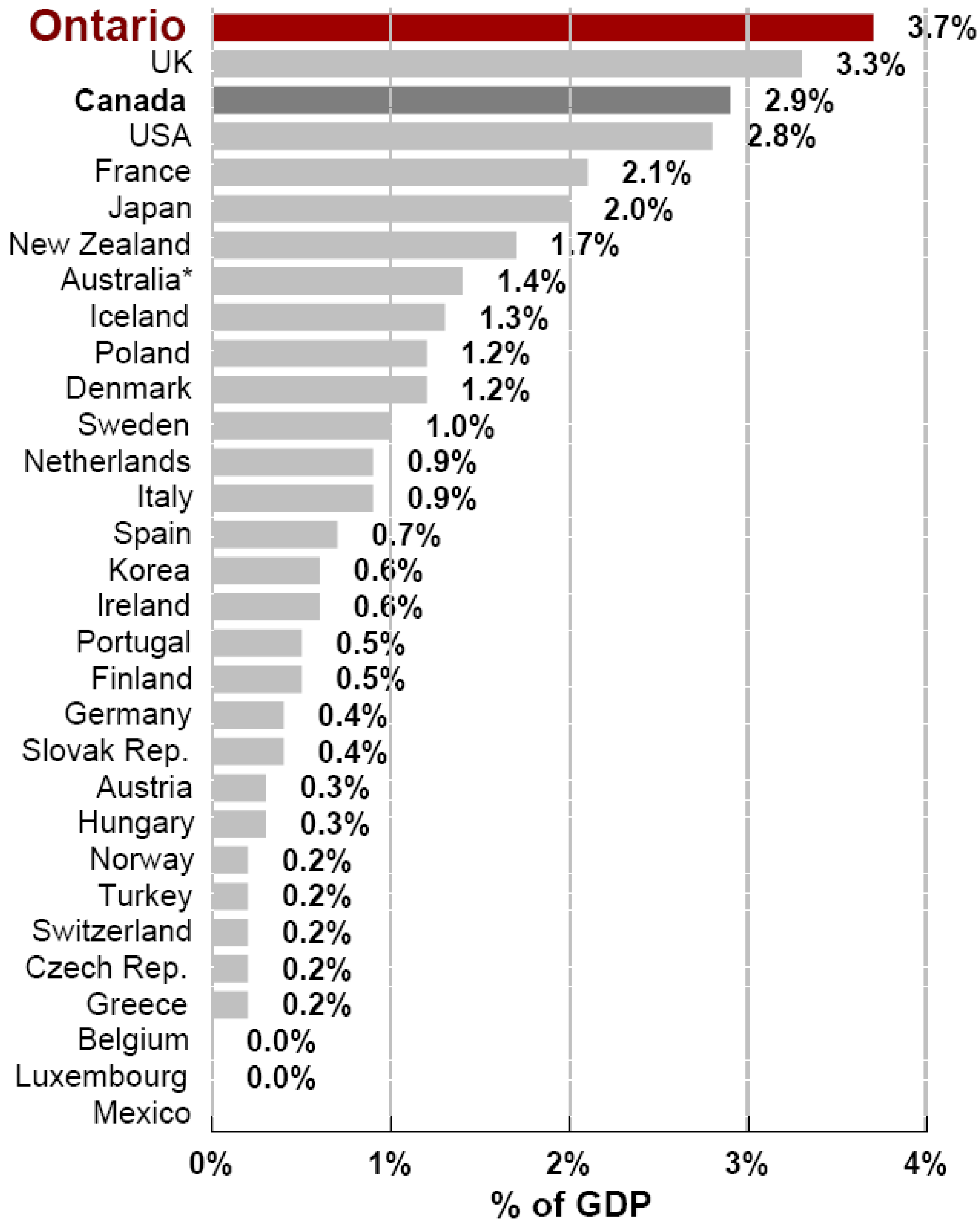
Expenditures ($26B):



Revenues ($ 26B):



<u>Appendix B</u>: Property Taxes as a Share of Gross Domestic Product (GDP) - 2004



* 2003

Sources: OECD *Revenue Statistics 1965-2004* , Statistics Canada *Financial Management System*