ALBERTA'S COMPETITIVE ADVANTAGE:

EMPOWERING MUNICIPALITIES WITH NEW MUNICIPAL REVENUE SOURCES

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Executive Summary

Canadian municipalities are engines of economic growth, cultural diversity, education, and recreation. Their roles have grown at tremendous rates, as have their responsibilities. Not only does the public have greater expectations for the infrastructure and service delivery from municipalities, senior levels of government have downloaded responsibilities to local governments without adequate arrangements for operational funding.

The basis for determining municipal revenue sources is in need of change. Globalization, urbanization, the public's expectation of delivery for more "people" services; together with an aging infrastructure have changed the revenue needs of Canadian municipalities, especially in Alberta where urban growth is at an unprecedented high.

The fiscal disadvantage

Municipalities require a mix of revenue generating taxation strategies to ensure they flourish, add to our economy and don't crumble under the strain of fiscal disadvantage. Tax legislation needs to respond to a more urban Alberta landscape.

The federal and provincial governments have a significant fiscal advantage over municipalities: their revenue sources are varied, wide-ranging and 'elastic' - they grow with the economy.

These higher orders of government are independent bodies with extensive taxing and spending powers. Municipalities are creatures of the provinces. Their very existence is at the discretion of the province without independent status. Provincial governments have the power to change the rules of municipal governance, including how source revenues are shared, or not.

Although there are some shared responsibilities between the provinces and the federal governments, it has been the practice of the federal government to not interfere in municipal issues without provincial consent. In this limbo, municipal governments reside in a subordinate position without the autonomy to determine their revenue options.

Improving financial flexibility

Municipalities have less financial flexibility than other orders of government: the federal and provincial governments can budget for an operational deficit. The municipalities cannot.

The federal and provincial governments have unrestricted access to borrowing money for either operating or capital deficits. Municipalities do not. Provincial legislation requires municipalities to have balanced operating budgets, which means that they cannot borrow money for operating expenditures, can only borrow for capital projects and any payments made on the principal or operating debts must come from operating budgets.

This leaves municipalities without flexibility in financing operating costs, and with fewer revenue options.

The challenge of growth
Grant funding to the municipalities from the federal and provincial governments has been reduced significantly since 1988. But the number of 'strings' on these grants has increased, further eroding the municipalities' financial flexibility.

Municipal revenue sources are under increasing pressure. Higher orders of government have downloaded responsibilities onto municipalities while simultaneously cutting transfer payments. This downloading creates significant public pressure on municipal governments to perform these responsibilities, but the federal and provincial governments have not increased municipal funding or provided options for new revenue sources.

Increasing responsibilities, decreasing revenue sources
A fiscal imbalance occurs when resource revenues are not allocated in a way that's consistent with a government's constitutional spending responsibilities.

The consequence of municipalities taking on these responsibilities is further compounded by the impact of unprecedented urban growth, especially in Alberta. The result is fiscal imbalance:

> "the distribution of revenue resources between the federal and provincial/territorial orders of government is inconsistent with the cost of meeting their respective constitutional spending responsibilities. "
> Conference Board of Canada, 2002.

From 1988 to 2002, most big Alberta municipalities contributed on a net basis to both the federal and provincial governments. Calgary had the largest contribution.

Sharing the wealth
The province has managed the impact of Alberta's growth on its key services - health care and education - but municipalities continue to struggle with urban growth, aging and deteriorating infrastructure, and with debt.

In Alberta, the tremendous economic and population growth has provided the provincial government with enough revenue to eliminate the deficit, pay off its debt, spend more on programs per capita than any other government in Canada, and budget a surplus. Unfortunately, this financial success has not been properly shared with Alberta municipalities.

Growth-related revenue sources
Growth responsive sources of revenue are held exclusively by other orders of government. But the most significant source of municipal income - property taxes- responds poorly to growth. This must change.

If municipalities are to be sustainable, they must have access to revenue sources that respond to growth-related pressures. The very growth that brings prosperity to the federal and provincial governments has placed increasing pressure on municipalities' infrastructure and services; they are under strain. There must be fundamental change in how municipalities raise revenues to alleviate growth related pressures and ensure operational sustainability into the future.

Increasing responsibilities; changing roles
Pressures on the expenditure side of municipal budgets come from urban growth, aging and deteriorating infrastructure, and downloading from senior governments. Today's municipalities must meet broad community needs beyond traditional issues such as policing and transportation services. These include "people" services. This puts more pressure to widen the service responsibilities of municipalities and particularly those of big cities (Canada West Foundation, 2005).

The downside of urban growth
Demand for new infrastructure means expanded municipal capital expenditures for new roads, water and sewer lines, transit and libraries. It also creates additional municipal operating expenditures to operate these facilities, and deliver the services. But the federal and provincial governments retain the increased tax revenues that come with growth. Municipalities get the downside of urban growth, expenditure pressure.

Aging infrastructure
A growing proportion - as much as 50%- of public infrastructure in Canada is completing its first full life cycle. Merely maintaining existing structures isn't enough. Replacement and modernization is also required. Without sufficient funding to take care of these pressing infrastructure needs, economic growth will be severely constrained.

Asking for accountability
Downloading such responsibilities as social housing, and reducing funding for services such as policing, place additional pressures on Alberta's municipalities and prevent them from properly addressing issues that fall within their local sphere of jurisdiction.

Today, many Canadians believe that their governments are not held accountable. They are demanding clearer and greater accountability for the way their governments spend their tax money. Effective accountabilities require clear roles and responsibilities, and a balance of expectations and capacities. The municipalities' roles of providing services and the expectations for performances may be clear, but their related authorities and required financial capacities are missing. Without authorized revenue sources and adequate transfers from senior governments, municipalities are strained in playing their roles and reaching public expectations.

Finding other revenue sources
Municipalities are increasingly dependent on local property taxes and user fees. But property taxes are not directly related with ability to pay. Nor do they grow at the same rate as the economy. Municipalities increasingly rely on user fees, as well, to meet their budgetary needs. Historically, many municipal services are under-priced, resulting in significant municipal subsidizing of services. Many user-fee rates are targeted to remain under or at inflationary rates. The exception is Ontario and Alberta, where user fees are more in line with cost of service. This suggests that there are limited opportunities to expand user fees as a source of revenue in those two provinces.

Canadian municipalities are at a competitive disadvantage; they lack the ability to finance what they need to maintain their positions as centres of economic growth. To change this situation, municipalities need alternative, sustainable sources of revenue and policy levers.

Accessing new revenue sources
A mix of taxes would give municipalities more autonomy to meet the demands for services and infrastructure, as well as the flexibility to respond to local needs and changing conditions. In the past decade, the combination of downloading responsibilities from senior governments, decreases in intergovernmental grants, and corresponding increases in reliance on own-source revenues has changed the fiscal environment in which municipalities operate. The growing competitive disadvantages faced by municipalities have brought to the forefront the need for municipalities to gain access to new revenue sources.

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Mixing the revenue base—there is only one taxpayer
If municipalities were to receive a portion of resource revenues, a new revenue-sharing agreement would need to be structured with the Province. Municipalities are unable to take full advantage even of their one primary sources of revenue - property taxes - because the Province is crowding the tax room.

The Province made a commitment in 2000 to cap the province-wide (education) property tax at $1.2 billion. This commitment has been honoured only once - in 2001 - in the years since.

All orders of government obtain their revenues from the same taxpayer. It's how those revenues are divided that's at issue. With no debt, and continuing surpluses in the foreseeable future, the Alberta government has the capacity to help municipalities; either by creating more tax room or more gap-closing transfer programs.

Conclusion
Municipalities require a mix of revenue generating taxation strategies to give them more autonomy and flexibility to meet their citizen's needs while also ensuring their long-term operational sustainability. The benefits of this mix would result in helping municipalities offset discrepancies in the local tax system, help address the fiscal imbalance that exists between the provincial government and Alberta's municipalities, and help in providing infrastructure and services needed to ensure our province remains globally competitive throughout the 21st century.

1. Municipalities in a new fiscal environment

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1.1 The bases of municipal finance in Canada

1.1.1 Institutional background

Canada is a constitutional monarchy, a federal state and parliamentary democracy. In the current fiscal system, the federal government and provinces are independent governing structures with extensive taxing and spending powers. In contrast, municipalities are creatures of the provinces, and as such have no independent status. Accordingly, the power to spend and raise revenues is granted by provincial legislation, through municipal acts and additional statutes and regulations.

In Canada, the federal government shares a few areas of direct responsibility with the Province, and will not interfere with municipal matters without provincial consent. Provincial governments have the power to change the rules governing municipal responsibilities at any given time.

1.1.2 Operating and capital expenditures

Canadian municipal governments provide numerous services and have numerous responsibilities. The expenditures necessary to meet these responsibilities are traditionally divided into two categories – operating and capital expenditures.

- Operating expenditures include all costs related to day-to-day operations of the municipality, including the costs of providing policing and fire protection, regulating land use, animal control, and by-law enforcement.
- Capital expenditures are related to long-term improvements and new investments for providing municipal services, such as extending public transit, building and improving roadways, constructing and upgrading public facilities, and acquiring new land for the municipality.

1.1.3 Revenue sources for municipal, provincial and federal governments

In Canada, the federal government has access to various revenue sources without any restrictions, while provincial governments have access to revenue sources in any form of direct taxation (although the ability of the provinces to levy the income tax may be limited by a federal/provincial agreement). The diversity of revenue sources, combined with the revenue-generating potential of these sources, is a significant fiscal advantage for the senior governments.

- Federal government revenues include income tax, sales tax (GST), Employment Insurance (EI) and Canada Pension Plan (CPP) contributions, corporate taxes, a variety of duty and excise taxes, and others.
- Provincial governments have provincial income tax, sales tax, property tax, corporate tax, gasoline and tobacco tax, gambling revenues, resource royalties, federal transfers, and others.

On the contrary Canadian municipalities have very limited revenue sources because their power to raise revenues is granted by their provinces. These revenues include property tax, business tax, user fees, and intergovernmental grants. The disadvantage of these narrow revenue sources is:

- the property tax, our main source of revenue, is constrained by its inability to grow with the economy, and
- the intergovernmental grants are not a reliable revenue source. These transfers change with senior governments' priorities, which do not always match changes in municipal priorities.

1.1.4 Debts and budget deficits

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Along with different responsibilities and revenue sources, there are different debt-funding structures for the three orders of governments in Canada.

- For example Alberta legislation requires municipal governments to have balanced operating budgets, which means that:
  - municipalities cannot borrow money for operating expenditures;
  - municipalities can only borrow for their capital projects.
  - The principal and interest payments of these debts come from the municipalities' operating budgets.

In contrast, both federal and provincial governments have unrestricted access to borrowing money for either form of expenditures. In other words, although all three levels of government may have debt, only federal and provincial governments can budget for operating deficits. Therefore, municipalities have:

- less flexibility than the other orders of government in financing operating costs, and
- fewer revenue options.

1.2 Changes from senior governments

[redacted]

In addition to having limited revenue sources and without the right to budget for operating deficits, municipalities now have increasing pressures from senior governments who:

- download responsibilities, and
- cut transfers.

1.2.1. Downloading of responsibilities

During the 1990s, both federal and provincial governments downloaded services to municipalities in many areas in their efforts to decrease spending and achieve balanced budgets. The key areas downloaded by the federal government include:

- municipal airports,
- local ports, and
- local harbours;

Provincial government downloads include:

- transit,
- child care,
- social housing,
- social assistance,
- ferries,
- selected airports, and
- property tax assessment (TD Bank, 2002a).

These downloads created significant public pressure for municipal governments to perform responsibilities without accompanying the increased funding or new revenues from other orders of government.

1.2.2 Cutting of transfers

The most dramatic decline in municipal revenues has been the decreased grant funding provided by other orders of governments. In 1988, transfers accounted for 22.5% of all municipal government expenditures in Canada; in 2001, the comparable amount decreased to 16.6%. Over the same period, federal grants as a percentage of municipal government expenditures fell from 0.7% to 0.4%, and provincial grants declined from 21.8% to 16.2%. Overall, from 1988 to 2001, provincial grants to municipalities declined significantly in every province except Quebec. (*Kitchen and Slack*, 2003).

In this same period unconditional grants, as a share of total grants, decreased and the percentage share of conditional grants increased. The increase of conditional grants allowed senior governments to increase their influence in municipal expenditure choices, thus reducing municipal autonomy and flexibility.

1.3 Fiscal imbalances

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The term fiscal imbalance has been used to describe different concepts. The Conference Board of Canada (2002) described fiscal imbalance as

> "the vertical imbalance exists when the distribution of revenue resources between the federal and provincial/territorial orders of government is inconsistent with the cost of meeting their respective constitutional spending responsibilities".

The K&L consulting report (2003a) gives another definition of fiscal imbalance: A fiscal imbalance happens when

> "regions with wealthier and younger taxpayers and regions that are more industrialized will pay more in taxes than they will receive in the form of government-provided goods, services and transfers."

Several analyses have attempted to estimate fiscal imbalances based on the latter definition. Among those studies, K & L (2003) and The Centre of Spatial Economics (2005) established methods to calculate these imbalances. Using this method, The City of Calgary estimated financial flows for a selected number of Alberta municipalities. The result is that from 1998 to 2002, most big Alberta cities contributed on a net basis to both federal and provincial governments. Among these cities, Calgary had the largest contributions.

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The tremendous economic and population growth in Alberta has provided the provincial government with enough revenues to:

- eliminate its deficit,
- pay off its debt,
- spend more on provincial programs per capita than any other government (provincial or federal) in the country and
- budget for a $4.1 billion surplus for the 2006/07 fiscal year.

Unfortunately, the financial success experienced by the provincial government has not been properly shared with Alberta municipalities. While the provincial government has managed the impact of Alberta's growth on its key services such as health care and education, municipalities continue to struggle with urban growth, aging and deteriorating infrastructure and continue to carry capital debt. This is largely due to the fiscal imbalance that exists between Alberta's municipalities and the provincial government. This imbalance is most obvious when comparing municipal and provincial revenue sources.

Municipalities do not have access to revenue sources in their own communities that are available to other orders of government. In a recent survey conducted by the Federation of Canadian Municipalities, it was noted that:

- provincial and federal governments have enjoyed an average 25% increase in their revenues from 1996 to 2001,
- while municipalities have experienced only an average 14% increase in their revenues during that period.

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At the same time the economic and population growth experienced in many Alberta municipalities in recent years has placed increasing pressures on the infrastructure and services – roads, utilities, fire, police, parks and recreation facilities - that helps to support Alberta's growth. However, growth-responsive sources of revenue, such as income and excise taxes are held exclusively by other orders of government while the most significant source of municipal income – property tax – corresponds poorly to growth.

Based on Conference Board of Canada (April, 2006) projections,

- The Government of Alberta will enjoy a 43% increase in their total revenues over the next ten years.
- Provincial resource royalty revenues are expected to increase by 38% during this time while
- Corporate and personal income taxes are expected to generate 50% and 54% more revenues respectively for the Government of Alberta.
- In addition the provincial government is projected to enjoy a 38% increase in other sources of revenues including transfers from the Government of Canada over the next ten years.

The Government of Alberta is projected to see their property tax revenues increase by just 31% over the next ten years. The provincial government's wide array of revenue streams (a large portion of which are growth revenues) tends to mitigate the weakness of the slower growth property tax portion of their revenues. As property taxes are the primary source of revenues for municipalities, if there is no significant change to the fiscal imbalance between the provincial and municipal governments, then over the next ten years municipalities will continue to have (as their primary source of revenue) one of the slowest growing revenues available to any order of government. If municipalities are to continue growing and be the key strengths behind Alberta's economic success, this must change. How municipalities raise revenues to alleviate the growth related pressures they face and ensure their operational sustainability into the future requires fundamental change. Unless this fiscal imbalance is addressed Alberta's municipalities will need to expand the use of debt financing and will continue to fall behind on meeting their citizens' infrastructure and service needs.

2. Why Municipalities need alternative revenue sources

2.1 Canada as an urban country

Today's Canada is predominantly an urban country. According to Statistics Canada's Census data (2001), 80% of Canadians now live in urban areas (centres with more than 1,000 people). Alberta has also experience this trend. In Alberta, 25% of the total population lived in urban areas in 1901, while a hundred years later this ratio increased to 81%.

2.1.1 Urbanization and the evolution of municipalities in the global economy

As the Canadian economy evolved from a resource and manufacturing-based economy to a more global and knowledge-based economy, urban centres became homes to young, educated and highly skilled workers, centres of research, development and innovation, as well as the gateways to global trade. Due to urbanization and globalization, municipalities have become engines of the Alberta's economy.

Growth: Globalization
The shape of municipalities has changed dramatically since the beginning of the 1990s, as globalization accelerated. The adoption of the Canada-U.S. Free Trade Agreement (FTA) and the North American Free Trade Agreement (NAFTA) opened the Canadian economy to the free flow of goods and capital, and boosted export-oriented manufacturing industries and related services. The ratio of Canadian international exports to inter-provincial exports changed from 1:1 twenty years ago to 2:1 today, indicating that provinces tend to trade more with other countries than with each other. The value of international exports has grown from 21% of Canada's GDP in 1981, to 41% in 2002.

Growth: Exports
Among provinces, those with higher densities of urban populations have experienced higher growth in international exports relative to total international and inter-provincial exports. For example, in 2001, Alberta with an urban population of 81%, saw its ratio of international exports to total exports grow from 34% to 63% between 1981 and 2002. On the contrary, provinces with lower urbanization rates like Newfoundland (58% in 2001) and New Brunswick (50% in 2001) didn't grow very much or even declined in terms of international exports. From 1981 to 2002, the ratios of international exports to total exports increased from 46% to 56% in New Brunswick, and declined from 73% to 60% in Newfoundland.

Growth: GDP
The importance of urban areas to the Canadian economy can be illustrated by a 2002 TD Bank report. The report calculated the percentage of GDP that some municipalities contribute to their province's total GDP. In Alberta, the report noted that Calgary and Edmonton combined accounted for 64% of Alberta's GDP.

Growth: A hub for working opportunities
Calgary is a good example of the evolution of Canadian municipalities. During the past fifteen years, about 250 thousand people have moved to Calgary for job opportunities and a higher quality of life. For example, although Calgary constitutes only 2.9% of Canada's population, it had a 4.2% share of the national job creation in 2004. Today, the city is not only an international player in the oil and gas industry, but also serves as a centre of innovation that attracts capital investments from the world and has one of the youngest and most highly skilled workforce in the country (Canada West Foundation, 2005).

2.1.2 A young, diverse and well educated work force

The young, diverse and well educated workers who are needed for success in a global economy are attracted to large urban centres that offer various services, lifestyle choices and recreation and entertainment opportunities. Thus, the success of a country and a province is increasingly being defined by the successes of its municipalities in competing with other municipalities world wide for workers. To compete globally, municipalities need to invest in their infrastructures with sufficient and reliable financial resources.

According to Statistics Canada, the population in the top 27 Census Metropolitan Areas (CMAs) increased from 48% of the total Canadian population during the 1960s to 63% in 2001. 50% of the Canadian labour force, that is Canadians aged 15 and above, live in one of Canada's nine largest municipalities and 80% of the total population lives in urban areas. In Alberta, 65% of the labour force lives in either Calgary or Edmonton and 77% overall live in urban areas.

Because the labour force aged 25-44 years old is considered to be the most productive group, it is important to look at the locational trend of this group. K&L (2003) concluded that

> "although the percentage of the labour force aged 25-44 is falling in all areas of country, it is falling considerably less in large cities."

There are two reasons to explain this observation:

1) Job opportunities in the municipalities continually attract young workers from rural areas;
2) International in-migrants who are typically in the 25-44 age cohort tend to settle in large municipalities.
   - In addition, international immigrants come to Canada with higher average education levels than Canadians.
   - They settle in big cities and offer employers work force with diverse skills and experience.

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2.2 Expenditure pressures and revenue constraints

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2.2.1 Expenditure pressures

Today's municipalities have greater responsibilities beyond traditional issues such as policing and transportation services. They must meet broad community needs, such as services for the homeless, support for local arts and culture, and hosting new Canadians. Compared to the traditional responsibilities related to "property" services, the non-traditional responsibilities are directed toward "people" services that possess a strong social element or income redistribution.

Although many take the position that municipalities should avoid engaging in "people" services or activities that have strong social or income redistribution aspects, disentanglement is difficult given the high interconnection among today's governments. Many citizens also expect broader services from their local governments. This puts more pressure to widen the service responsibilities of municipalities and particularly those of big cities (Canada West Foundation, 2005). Currently, there are three main pressures placed on the expenditure side of municipal budgets:

- urban growth,
- aging and deteriorating infrastructure, and
- downloading from senior governments.

a) Pressures from the urban growth

[redacted]

As a municipality grows, the expanded population puts demands on existing infrastructure and creates additional demand for new infrastructure. This means expanded municipal capital expenditures for new roads, streetlights, sewage and water lines, public libraries, recreational facilities, and transit. Higher demand also creates additional municipal operating expenditures in the form of increased service supply, such as garbage collection, use of water and sewage, and expanded transit services.

A growing population is not ordinarily problematic for governments (Canada West Foundation, 2005), because it leads to economic growth and thus increased tax revenues. The problem is that the benefit of increased tax revenues is not captured by municipal governments. It is retained by federal and provincial governments.

Consequently, municipalities get the downside of urban growth: the expenditure pressure.

This is especially true for Alberta's municipalities. From 1991 to 2005, Alberta's labour force population grew from 1.9 million to 2.5 million at an average 2% annual growth rate. Of this growth, Calgary and Edmonton's share was 69% growth. Because labour forces are main contributors to economic growth, cities like Calgary and Edmonton have been major contributors to Alberta's booming economy.

- In the fiscal year 2005-06, the provincial government of Alberta earned $34.6 billion in revenues, leaving a $7.3 billion surplus,
- Yet, in this boom economy municipalities contributing to growth are still struggling with unrealistically tight budgets.
- Calgary's surplus in 2005 was $1.8 million which represents 0.1% of its operating budget.

b) Pressure from the aging and deteriorating infrastructure

[redacted]

Until recently, the relative youth of Canadian municipalities meant that the pressure on Canadian governments to re-invest in infrastructure was relatively modest. But the infrastructure systems in Canada are now aging. Public infrastructure is completing its first full life-cycle. Statistics show that:

- 28% of Canada's total public infrastructure is over 80 years old,
- 31% is 40 to 80 years old, and
- only 41% is less than 40 years old.

Merely maintaining existing infrastructure is not enough. Replacement and modernization is also required.

This fact has resulted in a municipal infrastructure shortfall in Canada that is growing by about $2 billion a year. An estimate by the Association of Consulting Engineers of Canada shows that the total municipal infrastructure deficit in Canada is at least $44 billion, of which $17 billion is attributed to under-investment in roads and highways (TD Bank, 2002). Without sufficient funding, there will be cutbacks to:

- maintaining, replacing, and upgrading the existing infrastructure,
- spending that is needed to fulfill life-cycle maintenance requirements, and
- expanding or building new infrastructure to accommodate growth.

As a result, economic growth would be severely constrained.

In addition Alberta faces a similar challenge with regards to its infrastructure. According to a September 2005 report by the Alberta Chamber of Commerce and the Certified General Accountants Association of Alberta, the infrastructure debt for the municipal sector is estimated at $5.7 billion. The report acknowledges that the current actions the Government of Alberta is taking (within the existing municipal finance structure) but also notes that the province's actions do not include any reforms to how municipalities actually fund the services they provide. They further note that the provincial governments current actions "will not provide a long-term solution" for the "outdated and inefficient local government finance model" (Vision 20/20: Population and Fiscal Stresses in Alberta Municipalities)

c) Pressure from the senior governments' downloading

In an effort to balance its budget and begin paying down its debt, the Government of Alberta cut funding to a variety of provincial programs. Some of these programs, such as the police grant, provided direct funding to municipalities. Other cuts impacted programs that were clearly a provincial responsibility but nonetheless impacted municipal operations.

For example, despite the federal and provincial responsibility for social housing, local governments have had to step in to fill the gaps not being met by the senior governments. The lack of a national housing strategy since the mid-1980s contributed to the problem of homelessness in Canadian municipalities. Municipalities have had to spend more on social housing and social services, leaving less funding available for their own traditional areas of responsibility (such as infrastructure).

[redacted]

In addition, providing an adequate level of funding for policing should be an important concern for all orders of government. Currently the provincial government provides Calgary a grant that covers approximately 6.5% of the total operating costs for Calgary's police service. Given the high degree of control that the provincial government exercises over policing in Alberta, it is clear that the provincial financial contribution for this service is inadequate.

Further, the provincial government has acknowledged that emergency medical services are in fact part of the health care system. It has even been announced that the provincial government would take over funding and operation of Alberta's ground ambulance service system. However, this announcement has yet to be implemented and there continues to be a lack of clarity about the provincial government's role in this area.

These examples of downloading place additional financial burdens on Alberta's municipalities and prevent them from properly addressing issues that fall within their local sphere of jurisdiction.

2.2.2 Revenue sources that do not match municipalities' changes in expenditure

a) Intergovernmental grants

[redacted]

In addition to downloaded spending responsibilities, grants from the Government of Alberta municipal governments have steadily declined. For example, in Calgary the ratio of public transit grants to total transit expenditure decreased from 8% in 1991 to an average 0.8% between 2001 and 2004, while the ratio of grants for social housing and social services relative to expenditure in these areas declined from 37% in 1991 to an average of 7% between 2001 and 2004.chart

This situation questions government accountability, a critical element of a representative democratic government. According to the Office of the Auditor General of Canada, a modernized definition of accountability is

> "a relationship based on obligations to demonstrate, review, and take responsibility for performance, both the results achieved in light of agreed expectations and the means used."

Today, many Albertans believe that their governments are not held adequately to account. They are demanding clearer and greater accountability for the way their governments spend their tax money.

Effective accountabilities require clear roles and responsibilities, and a balance of expectations with capacities. The municipalities' roles of providing services and the expectations of performances may be clear, but their related authorities and required financial capacities are missing. Without authorized revenue sources and adequate transfers from senior governments, municipalities are strained in their roles and reaching their performance expectations.

b) Property tax and user fees

[redacted]

Over the past few years, the combination of falling grant funding and downloading various expenditure responsibilities has increased municipalities' dependence on local property taxes and user fees.

Property tax revenues are inherently flawed as a source of funding for municipalities' growing needs.

- First, the property tax is based on assessed property values that do not have a direct relationship with ability to pay, in the way income taxes do. Consequently, it is a poor match for funding in the area of income redistribution services, such as social services and social housing.

- Second, the property tax is not an "elastic" source of revenue, because the tax base does not grow at the same rate as the economy. Since the tax base links directly to only one of aspect of the economy – real estate – it sometimes increases at less than the rate of overall economic growth.
- Third, the high commercial property portion of property tax decreases the competitiveness of municipalities in attracting businesses. Some economists also point out that the property tax is a tax on capital. It is problematic since capital taxes target savings and investment – the fuel that drives the engine of economic growth, innovation, and increased productivity (Canada West Foundation, 2002).
- Fourth, raising property rates above those of adjacent areas can lead to "suburban flight", thus reducing a municipality's tax base and leading to urban sprawl issues.
- Finally, there is significant public resistance to property tax increases because the property tax is highly visible. Increases in property taxes therefore have politically acceptable limits, even if part of a portion of the "increase" is accounted by inflation.

In addition to property taxes, municipalities are relying more on user fee revenues to meet their budgetary needs. Historically, many municipal services are under-priced, resulting in significant municipal government subsidies for services. It is reported that user fee increases in many municipalities, when applied, are still targeted to remain at or under inflationary rates. The exceptions are Ontario and Alberta, where municipalities are already making good use of user fees (Mintz, 2006). This suggests that there are limited opportunities in these provinces to expand user fees.

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Conclusion

As engines of economic growth and centres of innovation, education, recreation and cultural diversity, Alberta's municipalities are the gateways through which Alberta competes on the global stage. The current legal, financial and policy structures available to Alberta's municipalities result in having the fundamental needs of citizens being met by the order of government with the fewest financial resources and the most legal restrictions. Safe streets, clean water, reliable transportation and a wide variety of recreational opportunities are the foundations on which the success of our municipalities and our province rests. Yet the tools that municipalities must rely on to achieve that success were originally developed in the 19th century and are not well suited for today's challenges.

It is clear that a change in approach is needed. Senior orders of government need to empower municipalities with sufficient authority to access a wider range of revenues. Municipalities require a mix of revenue generating taxation strategies to give them more autonomy and flexibility to meet their citizens' needs while also ensuring their long term operational sustainability. Regardless a better mix of revenues for municipalities would help offset discrepancies in the local tax system and help address the fiscal imbalance that exists between the provincial government and Alberta's municipalities. There will be challenges to finding solutions that will benefit the entire municipal sector, the provincial government and citizens. Not all new revenues tools will benefit every municipality equally and a method will need to be created to ensure this challenge is properly addressed. Further, a higher degree of cooperation and coordination among neighboring municipalities will be needed to ensure the ultimate successful implementation of some of the proposed revenue tools.

The success that Alberta experiences now and in the future is increasingly being determined by our municipalities' success in providing the infrastructure and services needed to continue being globally competitive throughout the 21st century. Addressing the fiscal imbalance by providing municipalities a better mix of revenues will help ensure Alberta remains a leading global competitor well into the future. The discussion between the provincial government and Alberta's municipalities should begin as soon as practicable. Further delay will simply exacerbate the problems facing local governments. Alberta's municipalities are fully prepared to work with the provincial government to come up with and implement practical solutions that will address the provincial/municipal fiscal imbalance to the benefit of Albertans and their local and provincial governments.

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