Financing Large Cities and Metropolitan Areas

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Outline of Presentation

■ How are large cities and metropolitan areas different than other cities?

■ How should they finance services?

■ How should they finance infrastructure?

■ Are large cities treated differently in practice?
Demographic and Economic Differences

Demographic:
- Larger population
- Higher population density
- More heterogeneous population

Economic:
- Generate employment, wealth, and productivity growth
- Key to the economic success of the country
Expenditure Differences

- Expenditures per capita are higher in large cities and metropolitan areas:
  - Operating expenditures in London are about 48% above the average for all local governments in the country
  - In Toronto, expenditures per household are about 44% higher than municipalities in the surrounding region
Expenditure Differences

- Large cities provide more services than governments in smaller urban and rural areas.

- Large cities not only have to ensure transportation and communications infrastructure to attract businesses, they also have to provide services that will attract and retain highly trained human capital.
Expenditure Differences

- High concentration of special needs -- higher expenditures on social services, social housing, and public health
- Higher concentration of people -- more specialized police services
- Higher densities -- more specialized training and equipment for fire fighters
- Public transit system only in large cities because of the density required
- Major cultural facilities only in large cities because they require a minimum size
Economies of Scale?

- Spreading fixed costs over a larger population lowers per capita costs (e.g. public transit)

- Economies from bulk purchases (e.g. busses, computer equipment, etc.)

- Lower overhead costs from amalgamation of municipalities
Economies of Scale?

- Empirical evidence shows economies of scale are very service-specific.
- Some economies of scale in central administrative functions; services with large capital inputs e.g. transportation, water and sewage systems.
- Difficult to draw municipal boundaries based on economies of scale.
- Cities can also become too large – diseconomies of scale.
Revenue Raising Differences

- Greater ability to raise revenues:
  - Property tax – higher property values; more commercial and industrial properties
  - Income taxes – higher level of economic activity
  - Sales taxes – higher level of economic activity; tax generates significant revenues from commuters and visitors

- Factors less mobile in large geographic area
How Should Large Cities be Financed?

- Large cities should have greater fiscal autonomy than other urban or rural areas –
  - greater responsibility for local services
  - greater ability to levy own taxes and collect own revenues
  - less dependence on intergovernmental transfers
Options for Financing Large Cities

- User fees

- Taxes:
  - Property tax
  - Income tax
  - General sales tax
  - Selective sales taxes

- Intergovernmental transfers
User Fees

- Appropriate for water, sewage, garbage collection and disposal, recreation, electricity

- User fees are especially important in large metropolitan areas because marginal cost pricing will improve efficiency by imposing higher charges on far away consumers

- Tolls on major roads: reduce congestion
Property Tax

- Good tax for cities:
  - Immobile
  - Visible
  - Accountable

- But …
  - restricts revenue flexibility -- no country is able to raise more than 10% of total tax revenues from the property tax
  - metropolitan areas need more than the property tax to deliver a wide range of services
Income Tax

- Highly responsive to changes in the economy; offers buoyancy during growth times; problems in economic downturns
- Progressive tax
- Large metropolitan areas provide substantial services to people (e.g. health, social services); not capitalized into property values
- Piggyback onto higher level income taxes with locally set tax rates
Sales Tax

- Responsive to changes in the economy; offers buoyancy during growth times; revenue problems in economic downturns
- Taxes benefits enjoyed by commuters and visitors
- Scope is limited because of distortions such as erosion of tax base when people shop elsewhere or seek substitutes
- Piggyback onto higher level taxes with locally set tax rates
Selective Sales Taxes

- Some are benefit-related (e.g. vehicle registration tax is related to road use and external effects such as pollution and congestion)

- Can affect consumer behaviour e.g. taxes on cigarettes reduce smoking; vehicle taxes reduce automobile use

- Can create economic distortions – base is small so rates may be high; high rates increase potential for evasion

- Low administrative cost (limited number of vendors)
Selective Sales Taxes

Examples of selective sales taxes:

- Motor vehicle tax: benefit-related; reduces road use
- Fuel tax: benefit-related; reduces road use
- Hotel tax: pays for services to tourists and visitors
- Alcohol tax: discourages use of alcohol; could be used to cover a portion of policing costs
Intergovernmental Transfers

- Large cities have less need to rely on unconditional transfers than smaller cities because they have greater revenue raising capacity.

- There is a case for transfers for large cities where:
  - they are providing services such as health and education.
  - services spill over metropolitan boundaries (e.g. regional transportation).
Financing infrastructure

- Borrowing
- Development charges
- Tax increment financing
Borrowing

- Synchronizes costs and benefits over time
- Allows for immediate benefit from infrastructure investment
- Allows municipalities to avoid large year-to-year fluctuations in local taxes
- Larger cities have greater ability to borrow without upper level assistance; higher credit ratings than small cities
Development Charges

- Charge per lot or per hectare to cover growth-related capital costs associated with new development or redevelopment
- Covers cost of off-site infrastructure (e.g. highways, sewer lines, etc.)
- New growth pays for itself and is not a burden on existing taxpayers
- If levied on a development by development basis, development charges can lead to efficient land use decisions
Tax Increment Financing

- Designate TIF area and then earmark future growth in property taxes to pay for infrastructure investments

- Borrow (issue TIF bonds) on the basis of anticipated increased property tax revenues

- Development financed from increase in tax revenue
Are Large Cities Treated Differently?

- No comparable data on metropolitan cities

- City-states (e.g. Berlin, Hamburg, Bremen, Brussels) are assigned state and local responsibilities and revenues

- Some cities have special taxing powers (e.g. land transfer taxes, vehicle registration taxes in Toronto; additional taxing powers in New York City)
## Taxes in Three Cities

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<th>Toronto</th>
<th>Berlin</th>
<th>New York City</th>
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<td>Property tax</td>
<td>Land (state) taxes and tax shares:</td>
<td>General property</td>
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<tr>
<td>Land transfer tax</td>
<td>Land (state) plus local shares:</td>
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<td>Share of corporate income tax</td>
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<td>Vehicle registration tax</td>
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<td>Billboard tax</td>
<td>Real estate transfer tax</td>
<td>Local taxes: General corporation</td>
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<td>Motor vehicle tax</td>
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<td>Inheritance tax</td>
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<td>Tax on betting and lotteries</td>
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<td>Fire protection tax</td>
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<td>Beer tax</td>
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Summary

- Large metropolitan areas should be able to raise and spend budget themselves; reduce dependence on transfers
- May need transfers for health and education
- User charges where appropriate
- Property tax plus broader based taxes (income and sales) because factors are less mobile in a larger geographic area
- For infrastructure: borrowing, development charges, tax increment financing