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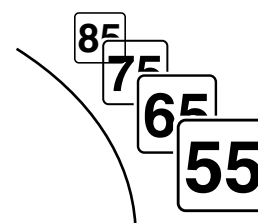
No Seniors' Specials

Financing Municipal Services in Aging Communities

Harry Kitchen

In determining how municipal services should be funded, the same public finance principles apply to all: services for seniors are no exception.

Le financement des services municipaux aux aînés ne doit faire exception : les principes sont les mêmes, pour tous.



*Faces of Aging
Les défis du vieillissement*

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Summary

With population aging underway, Canadian cities and towns are facing growing pressures to accommodate the service needs of older residents. This raises difficult policy questions and financing dilemmas for municipalities, as it touches on important services like social housing, public transit and recreation. To what extent should local governments be financially responsible for age-friendly initiatives? Should they have access to new taxes or revenues to provide seniors' services? Is it still appropriate for them to grant lower user fees and discounted property taxes to seniors?

To examine these questions, municipal finance expert Harry Kitchen lays out an analytical framework and some guiding principles, using Ontario as a case study. He argues that all local services should be financed the same way, including those for the aged. They should be under municipal authority, except when they affect residents of other municipalities or if they have a redistributive role.

Municipal governments rely largely on property taxes, user fees and intergovernmental grants for revenue. Kitchen argues that seniors' services should be financed not through dedicated grants from the provincial and federal governments but rather through user fees and local taxes. Over the past few years the importance of user fees as a revenue source has been increasing, but municipalities tend to adopt pricing structures that do not reflect actual service production and delivery costs. Inefficiently set user fees send the wrong pricing signals and can lead to excess use of services and larger-than-required facilities.

Kitchen also argues that the practice of discounting property tax rates for seniors is not equitable and should be abandoned. This practice was established at a time when a high percentage of seniors were living in poverty, and it persists, even though seniors' poverty rates have decreased considerably compared with those in the rest of the population. Programs and grants should support all low-income individuals in need, regardless of age, says the author.

On the contentious issue of whether municipalities should have access to additional revenue sources, the author maintains that a broader tax mix would give municipal governments more flexibility to respond to local economic circumstances and expenditure needs. Reducing the reliance on property taxes would also mitigate the distortions these taxes create and their heavier burden on low-income individuals, including seniors in need.

As seniors' importance as a constituency grows, it will become more difficult for local government to introduce the changes necessary and to provide and finance the services their aging communities need. Failing to set the right course may have severe consequences in the near future, he concludes.

Résumé

En raison du vieillissement de la population, les villes et localités du pays sont de plus en plus confrontées aux besoins de leurs résidents âgés. Ces besoins touchent d'importants services comme le logement social, les transports publics et les activités récréatives, posant ainsi de sérieux dilemmes financiers pour les municipalités. Dans quelle mesure les administrations locales doivent-elles assumer la responsabilité financière des services aux aînés ? Faudrait-il leur donner accès à de nouvelles sources de revenu ? Devraient-elles continuer à offrir aux aînés des réductions sur les frais d'utilisation des services et, dans certains cas, sur l'impôt foncier ?

Pour examiner ces questions, le spécialiste des finances municipales Harry Kitchen établit un cadre analytique et certains principes directeurs en utilisant l'Ontario comme étude de cas. Il soutient qu'il faut appliquer les mêmes principes de financement à tous les services, y compris ceux aux personnes âgées. Ainsi, la responsabilité financière des services aux aînés devrait relever des autorités municipales, à moins que ces services ne touchent aussi des résidents d'autres villes ou n'aient une fonction redistributive.

Les municipalités tirent une grande partie de leurs revenus de l'impôt foncier, des frais d'utilisation et des subventions intergouvernementales. Néanmoins, le financement des services aux aînés devrait surtout reposer sur les frais d'utilisation et les impôts locaux, estime l'auteur, et non sur des subventions fédérales et provinciales spécifiques. Ces dernières années, les revenus tirés des frais d'utilisation ont augmenté, mais les municipalités maintiennent souvent des structures de prix qui ne tiennent pas compte des coûts réels de la prestation des services. Or tous frais d'utilisation établis sans souci d'efficience faussent la perception de ces coûts, ce qui peut favoriser un usage excessif des services et le développement d'équipements trop importants.

Les taux réduits d'impôt foncier dont profitent certains aînés ne sont pas équitables et devraient être supprimés, ajoute l'auteur. Ils ont été fixés à une époque où beaucoup de personnes âgées vivaient dans la pauvreté, mais depuis, la prévalence de la pauvreté chez les aînés a sensiblement diminué par rapport au reste de la population. Ainsi, les programmes et subventions devraient soutenir tous les citoyens à faible revenu, quel que soit leur âge.

Sur la question litigieuse de l'accès des municipalités à des sources de revenu supplémentaires, l'auteur soutient qu'une composition élargie des recettes fiscales leur accorderait plus de flexibilité pour faire face à leurs dépenses. En réduisant leur dépendance à l'égard de l'impôt foncier, on atténuerait aussi l'effet de distorsion que cette taxe crée tout en allégeant le fardeau fiscal des citoyens à faible revenu, y compris les aînés dans le besoin.

Plus la population des Canadiens âgés gagnera en importance, plus il sera difficile pour les municipalités de faire les changements qui s'imposent. En tardant à apporter les correctifs proposés, elles s'exposent à de lourdes conséquences, conclut l'auteur.

No Seniors' Specials: Financing Municipal Services in Aging Communities

Harry Kitchen

The current trend toward an aging population in Canada has changed the way in which municipalities think about services for which they should be responsible and the way in which these services should be financed. In 2013, there were nearly 5.4 million adults aged 65 and over in Canada, an increase of almost 30 percent since 2001. Seniors, defined as those who are 65 or older, now account for 15.4 percent of the Canadian population. It has been estimated that by 2036 the number of seniors will exceed 10 million, accounting for almost 24 percent of the entire population.¹ Municipal officials are fully aware of this changing demographic pattern. Indeed, it is a major impetus behind a number of recently adopted age-friendly strategies in cities and towns across Canada.

Some Canadian cities have initiated special programs and services to accommodate an aging population. The more notable ones include recreation and cultural programs and activities, public transit that is more accessible for those who are mobility challenged, social housing and not-for-profit long-term care homes, and subsidized user fees for seniors' access to certain facilities or services. For example, Vancouver has set up a program to facilitate "the development of low-cost housing for older residents...and to increase the amount of seniors' housing constructed in proximity to neighbourhood centres and shopping areas" (FCM 2013, 21). Calgary has introduced a property tax assistance program to support low-income seniors facing property tax increases, as well as a home maintenance program that assists seniors with minor home repairs, snow removal and yard work (FCM 2013, 25). Many other cities are in the early stages of setting up committees, formulating a strategy and developing a plan to investigate the needs of seniors, including the way in which new or expanded services should be financed (City of Mississauga 2008; City of Ottawa 2012; British Columbia 2014).

These ongoing initiatives and those in the future will, in all likelihood, pose some notable challenges for municipalities, both in terms of service and program provision and in their funding. This growing emphasis on meeting the municipal service needs of an aging population raises a number of policy questions. For example, what is the municipality's degree of financial responsibility for providing services for an aging population? How should these services be financed? Is there a case for subsidizing municipal services that are intended primarily for the aged? Should the aged pay lower user fees (public transit charges, library fees and recreation charges, to name a few) and reduced property taxes to account for some services, such as education, that they do not use? Should municipalities have access to a range of new taxes or revenues to finance the range of services they provide? What are the consequences of not properly funding services for the aged?

In order to look at these issues, in the first part of this study I describe the role of municipal government in general. I then outline current municipal spending responsibilities — per capita spending levels and the relative importance of each service. Using data on municipal revenue

sources, I then present per capita revenue levels and relative importance by source of revenue. In the fourth section I identify and discuss a number of other issues often raised in providing and funding municipal services. The final section summarizes the study. In the appendix, I outline the principles used in evaluating municipal finance options.

The Role of Municipal Government

It is not uncommon to hear municipal politicians complain about the downloading or offloading onto municipalities of what are often perceived as provincial spending responsibilities. It is not my intent to engage in a discussion of whether this has happened, but rather to lay out an analytical and practical framework for determining the types and characteristics of services that should be funded by the province and the types that should be funded by municipalities. By clarifying and sorting out these funding responsibilities, both levels of government can increase their effectiveness and efficiency and the general public will have a better understanding of which government is responsible for funding which service and who is accountable for providing it. This is not the same as the production and delivery of public services (Batley 2001). Services may be delivered in a number of ways: by the municipal government itself, by contracting out to another governing unit, by contracting with the private sector, or through a nonprofit organization. Service delivery, however, is not discussed in this study; it is a separate issue that I have addressed elsewhere (Kitchen 2002, 2005, for example).

In general, a service should be a municipal responsibility when it reflects local preferences. If it generates a spillover (sometimes called an “externality”) or involves a redistribution of income, it should be a provincial responsibility (Kitchen 2013b).

What is a spillover?

A spillover occurs when the provision of a specific service in one (municipal) jurisdiction affects residents of other jurisdictions (municipalities). Positive spillovers occur if residents of neighbouring jurisdictions receive benefits from a service free of charge or for a user fee (price) or tax that is less than the service’s incremental provision cost. To illustrate, a positive externality exists when both residents and nonresidents of a municipality use a recreation facility (a sports field, a tennis court or a neighbourhood park, for example) that is primarily funded by property taxes levied on residents alone. Here, nonresidents are the beneficiaries of a positive externality because they are not paying for the facility that they are using. The externality can be removed if nonresidents start paying a charge that covers the incremental cost of the service used.

Negative spillovers occur when residents of neighbouring jurisdictions incur costs for services from which they derive no benefit or over the provision of which they have no say. For example, suppose a municipality pumps effluent into a river, making the water quality of the downstream flow so bad that residents in downstream municipalities can no longer swim in the river or drink water from it without purification costs. This externality can be removed by charging or taxing the polluters for the incremental cost of the damage they created, with the proceeds used to correct the problem causing the externality or to compensate those affected by it.

Which government level should be responsible for services that generate them?

Where benefits of a particular service accrue almost exclusively to local residents, the municipality concerned should have responsibility for setting policy, acting as service manager and financing the service. Where spillovers arise, there is a role for a governing jurisdiction that is larger than the municipality itself. If the spillovers are province-wide, there is a role for provincial responsibility. This could ensure that the proper level of service is provided and that all costs and benefits are taken into consideration in reaching decisions on service levels, quality and funding. If the spillovers are not province-wide but larger than the jurisdictional boundary of the municipality, there may be a role for district, regional or metropolitan governing structures to control and internalize the externalities.

What are income-redistributional services?

While some elements of income redistribution are inherent in most public services, “income redistribution” here refers to services such as social assistance, welfare payments, children’s aid, social or public housing and income transfers, to name the most obvious. These are specifically designed to help those who are in need of financial assistance meet their day-to-day expenditure commitments.

Which government level should be responsible for them?

Services that involve redistributing income to individuals, regardless of where they reside, should be funded by the federal and provincial governments. The reasons for this are, at the very least, twofold: first, senior levels of government have access to a broader mix of taxes, some of which are more closely related to ability to pay — income tax, for example; second, specific income-redistribution programs are more effective if administered across larger geographical areas, where there is a greater opportunity to redistribute income from rich to poor. This does not, however, suggest that these services need to be delivered by federal or provincial governments. Their delivery might be more appropriate if handled locally where administrators are familiar with local circumstances and in a better position to accommodate specific circumstances. Also, local delivery might be preferred if it generates cost savings. A potential downside of this type of arrangement, however, is that a loss in accountability can surface when one level of government makes spending decisions while another level of government raises the revenue.

What are services that reflect local preferences?

Services reflecting local preferences are those where spillovers are not widely prevalent and income redistribution is not an issue. Examples of such services include neighbourhood parks, local sidewalks and local streets. Here, service responsibility should rest with the municipality. A major advantage of this is that local preferences can be reflected in service levels and quality — important ingredients in securing efficient and accountable municipal governments. In addition, as long as each municipality is responsible for these services, a competitive environment is created (in the sense that neighbouring municipalities can benchmark the cost of providing specific services with each other), leading to stronger incentives for efficient and effective service provision. The same argument may be made for permitting neighbourhoods within municipalities to have different service levels; that is why some large cities, such as Halifax Regional Municipality, have subareas where tax differentials fund services of differing levels. In many

cities the property tax rates for highly urbanized areas are different from those in rural areas. Use of differential property tax rates through local area rating is a common practice for charging for enhanced infrastructure (rehabilitating or improving local streets and sidewalks) in specific parts of a city or town. Many cities and towns have downtown business development areas that are subject to higher property tax rates.

Although these principles are easily described, the actual task of assigning responsibility for policy setting and funding to either the province or municipalities on the basis of these criteria is not as clear-cut as it may appear. For instance, some individuals might perceive significant spillovers in certain services while others do not. Some might view some services as being entirely driven by local preferences while others might not. The assignment of service responsibility and funding to either the province or municipalities, then, partially reflects the views of the individual(s) making the assignment. In spite of difficulties in assigning unequivocal responsibility for all services, most analysts and policy-makers generally agree that the province should be responsible for all income-redistributional services such as social services, care for the aged, day nurseries and social housing. As well, there is general agreement that the municipal sector should be responsible for local streets and roads, solid waste, water and sewers, public parks and recreation, sidewalks and street lighting, fire and police protection, and so on. In general, application of the principles for assigning service responsibility results in a provincial/municipal allocation of major services similar to that in table 1.

Municipal Spending Responsibilities

Municipalities provide a wide range of services, but they do so within a legislative and operational framework that is tightly controlled and constrained by provincial governments (table 1). For example, municipalities are not recognized in the Canadian Constitution. Effectively, they are “creatures of the province” and, as such, operate under provincial statutes and regulations with powers and expenditure responsibilities, access to revenue sources, governance and structure directly or indirectly controlled by the province. Provincial legislation that controls and defines these responsibilities is in place in every province. If we take the province of Ontario as an example, it has been estimated that 150 pieces of legislation govern the operations of municipal government. A few provinces have also granted special legislation to a handful of cities (Kitchen 2013b), but these additional powers seldom come with access to new revenue sources or changes in spending responsibilities. The city of Toronto is an exception. Under the *City of Toronto Act*, which came into effect on January 1, 2007, Toronto has the authority to levy taxes on alcoholic-beverage entertainment establishments, motor vehicle ownership, land transfers, parking lots, road pricing and billboards. For these taxes, Toronto can determine the base, rate or amount of tax, methods of administration, collection and enforcement mechanisms, and any exemptions or rebates. Of these, the city has chosen to levy a land transfer tax and a billboard tax. For a short time it also levied a \$60 annual personal vehicle registration tax (PVT), but this was discontinued in 2011.

Even though changes have been made in municipal legislation in many provinces over the past decade or so, municipal governments are still tightly controlled and directed by provincial policy and legislation. An indication of these restrictions is noted here.

- Municipalities in every province are tightly controlled in their budgeting process. Until 2009, they were not permitted to budget for a deficit. If one emerged, either through lower revenues

Table 1. Model for allocation of responsibility for policy and funding of major public services, provincial and municipal governments¹		
Major service	Municipal	Provincial
Municipal government administration	√	x
Protection		
Police	√	x
Fire	√	x
Emergency planning	√	x
Roads		
Provincial highways	x	√
Local roads	√	x
Sidewalks	√	x
Street lights	√	x
Parking	√	x
Public transit		
Local	√	x
Regional ²	x	√
Health		
Hospital care	x	√
Preventive care or public health	√	√
Ambulance service	x	√
Social services		
Welfare assistance	x	√
Daycare services	x	√
Children's assistance	x	√
Homes for the aged	x	√
Social housing	x	√
Education		
Elementary and secondary	x	√
Post-secondary	x	√
Environment		
Water supply and distribution	√	x
Sewage collection and treatment	√	x
Solid waste management	√	x
Recreation and culture		
Community parks and recreation programs	√	x
Local libraries	√	x
Community centres, theatres and auditoriums	√	x
Convention facilities	√	x
Planning and development		
Local planning, zoning, severances and approvals	√	x
Local economic development	√	x

Source: Kitchen (2010, 68).
1. Allocation according to principles discussed in this study.
2. The GO Transit service provided in and beyond the Greater Toronto Area is one example.

or higher spending than was estimated, municipalities were permitted to borrow short term to cover the shortfall, but this amount had to be recovered in the following year's budget. This requirement meant that there was no ongoing or lingering debt for operational spending. In 2009, full accrual cost accounting became mandatory for municipalities across Canada. At the same time, the province of Ontario passed legislation permitting municipalities to pass budgets that do not cover certain noncash expenses. Exclusions include depreciation, postemployment benefit expenses and postclosure costs for landfill sites. All other expenses must be covered in the budget. For all intents and purposes, this revision has not changed provincial control over municipal budgets; municipalities must still prepare budgets that ensure sufficient funds are raised to cover operating costs and debt obligations arising during the year.

- ▶ The only long-term borrowing permitted is for physical infrastructure or capital projects.² Here, a variety of provincial controls or constraints are in place (Amborski 2013). Although there is some variation across the country, these generally include one or more of the following: permitting borrowing only for provincially approved capital projects; requiring prior approval of provincial authorities; restricting annual debt-servicing costs to an upper-limit percentage of municipal own-source revenues; restricting the amount of debt to an upper-limit percentage of assessed property values; and permitting (or requiring) borrowing from a provincially controlled "municipal fund." In essence, municipalities have little room to manoeuvre when it comes to financing infrastructure.
- ▶ Municipalities have access to only one major tax, the property tax. Here, municipalities set the general property tax rate³ but they are often restricted as to what they can do when it comes to levying differential taxes on different property types. In all but two cities — St. John's in Newfoundland and Labrador and Winnipeg in Manitoba — municipalities are required to levy a uniform tax rate on all properties. In Prince Edward Island and New Brunswick municipalities are required to levy differential tax rates on residential and nonresidential (commercial/industrial) properties with the differential rate fixed by legislation. For other differential rates, there are often provincial restrictions on the amount by which the commercial/industrial rate may exceed the residential rate. As well, the number of differential rates that are permitted range from a low of 2 in some provinces — one for residential properties and a second for commercial/industrial properties — to a high of 15 in Ontario, where variable rates may be applied to subcategories of commercial and industrial properties, vacant land, parking lots and so on (Kitchen and Tassonyi 2012; Ontario annual). In addition, there are property tax relief schemes available for seniors (based on age) and low-income residents (based on income).
- ▶ Municipalities have no control over the province when it comes to transferring spending responsibilities (downloading) or providing grants to municipalities.
- ▶ Frequently, municipal expenditures must meet provincial standards — building inspection, septic tank inspection, water and sewage treatment standards, police protection and fire inspection, to name a few.

Within this tightly controlled institutional framework, municipal governments provide a spectrum of services. At one end are those that have "private goods" characteristics, such as water supply and sewage and solid waste collection and disposal. For these services, one can identify

specific beneficiaries, individuals can be excluded if they don't use the service, income redistribution is not a goal, spillovers are few, and all operating and capital costs are measurable, including the "full cycle" cost of facilities and services over time.

At the other end are services that have "public goods" characteristics, such as local roads, neighbourhood parks, and fire and police protection. These generate collective benefits to the entire community or neighbourhood and income redistribution is not a primary concern. The benefits accrue to everyone in the neighbourhood or community rather than specific identifiable individuals. Other services that fall under this heading include those that are primarily income redistributive in nature — social services, social housing, land ambulance, preventive health care, and so on.

In between are services that have a mix of both private and public characteristics: major roads, highways, public transit, public recreation and libraries are examples (Kitchen and Tassonyi 2012; Kitchen 2002).

While the private/public service distinction is important for funding purposes (discussed in the next section of this study), let us set it aside for the time being and review the major services provided by municipalities. Table 2 records per capita spending on each municipal service⁴ along with the relative importance of each of these services for Ontario municipalities for each year from 2009 to 2012 (the latest year for which data are available). Restricting the data to Ontario is not a shortcoming, since Ontario accounts for 40 percent of all economic activity in the country and is the most heavily populated province. Municipalities in Ontario are responsible for funding more services than those in the other provinces; in particular, they are partially responsible for funding social services, including general assistance (although this has been falling over the past few years and is planned to end by 2019), child care and social housing (public housing, nonprofit cooperative housing and rent supplement programs). Ontario municipalities also fund 50 percent of land ambulance costs and 25 percent of mandated public health programs, and share the costs of long-term care homes and child care. This is not the case in the other provinces. Also, Ontario collects and disseminates the most comprehensive and thorough set of municipal data for analytical and comparative purposes (Kitchen 2013a).

Overall, municipal spending⁵ in current dollars showed a modest increase from 2009 to 2012, rising by 3.9 percent from 2009 to 2010; by 0.8 percent from 2010 to 2011; and by 1.4 percent from 2011 to 2012 (penultimate row of table 2). In constant dollars, the change was much less significant, rising by 1.4 percent from 2009 to 2010; falling by 2.1 percent from 2010 to 2011; and falling by a further 0.3 percent from 2011 to 2012 (last row of table 2).

When total expenditures are broken down by service, transportation accounted for the largest percentage of the total, at more than 22 percent in each year. Protection and social services were the next most important. In 2011 and 2012, each of these services accounted for around 17 percent of the total. For each year, environment accounted for 14 percent of the total, and recreation and culture for about 10 percent of the total. The remaining services accounted for about 18 percent of all spending.⁶

Table 2. Per capita expenditures and average annual change in expenditures, Ontario municipalities, 2009-12

Services	2009		2010		2011		2012		Average change	
	Per capita (\$)	% of total	Per capita (\$)	% of total	Per capita (\$)	% of total	Per capita (\$)	% of total	In current dollars (%)	In constant dollars (%)
General government ¹	116	4.2	130	4.6	151	5.3	134	4.6	5.3	2.7
Protection ²	451	16.5	476	16.7	497	17.3	508	17.5	4.2	1.7
Transportation ³	608	22.2	631	22.2	632	22.0	662	22.8	3.0	0.6
Environment ⁴	389	14.2	401	14.1	409	14.3	433	14.9	3.8	1.3
Public health ⁵	135	4.9	143	5.0	148	5.2	149	5.1	3.4	1.0
Social services ⁶	527	19.2	532	18.7	485	16.9	487	16.8	-2.5	-4.5
Social housing ⁷	173	6.3	181	6.4	173	6.0	170	5.9	-0.6	-2.7
Recreation, culture ⁸	262	9.6	266	9.3	289	10.1	279	9.6	2.2	-0.2
Planning, development ⁹	59	2.2	61	2.2	61	2.1	60	2.1	0.7	-1.5
Total	2,738	100.0	2,845	100.0	2,869	100.0	2,907	100.0	1.2	-0.3
Yearly change, in current dollars	-	-	107	3.9	24	0.8	39	1.4	-	-
Yearly change, in constant dollars	-	-	37	1.4	-59	-2.1	-2	-0.3	-	-

Source: Estimates by the author based on *Financial Information Returns: Municipal Performance Measurement Program*, Ontario Ministry of Municipal Affairs and Housing (<http://oraweb.mah.gov.on.ca/fir/welcome.htm>).

- ¹ Governance, corporate management and program support.
- ² Fire, police, court security, conservation authorities, building permits and protective inspection, emergency measures and application of the *Provincial Offences Act*.
- ³ Roads and streets, snow and ice removal, parking, public transit, street lighting and air transportation.
- ⁴ Water, sewage, solid waste collection and disposal, and recycling.
- ⁵ Public health, hospitals, ambulance services and cemeteries.
- ⁶ General assistance, assistance to the aged, and child care.
- ⁷ Public housing, nonprofit cooperative housing and rent supplement programs.
- ⁸ Parks, recreational facilities, libraries, museums and cultural services.
- ⁹ Planning, zoning, residential/commercial/industrial development, agriculture and reforestation, and tile drainage/shoreline assistance.

On a service-by-service basis, the average percentage change in both current (penultimate column of table 2) and constant (final column of table 2) dollars per capita was highest for general government expenditures. This was followed by per capita spending on protection, environment, public health and transportation, in that order. Per capita spending on social services and social housing decreased over the four-year period, primarily because the province has assumed a greater share of social service costs in recent years.

The services for which municipalities are responsible benefit the entire population, all ages. A municipal council's decision on spending — both level and trade-offs — is complex and variable. It may be affected by the urgency of achieving a certain service level or quality, the capacity to handle emergencies such as dealing with the aftermath of sudden and unexpected storms or local catastrophes, provincial requirements for meeting certain standards, the needs of the community including the elderly, the young, and those in between, the availability of grants, expenditure levels in comparator municipalities, a perceived capacity for raising taxes or user fees, and so on. There is nothing in the empirical or theoretical literature to direct municipal councils in making these hard choices. Broadly, however, Council does what it needs to do to meet the needs and desires of the community and this is what it is expected to do.

Municipal Revenue Sources

To meet expenditure needs, municipalities are faced with a restrictive set of revenue tools, at least by comparison with provincial and federal governments. They have only one tax⁷ (the property tax), some user fees (water and sewer rates, public transit, bag tags and tipping fees for solid waste, and recreation and library charges, to name the most common) and a miscellaneous collection of revenues from permits, licences, penalties, fines, revenue from other municipalities, development charges, gaming and casino revenues, government enterprise revenues, investment income and so on.⁸ In addition, some municipalities receive unconditional grants from the province and many receive conditional grants from both provincial and federal governments, mainly for infrastructure.

Choosing between user fees and local taxes

To examine when each of these revenue tools should be used, let us return to the earlier distinction between services with “private goods” characteristics and those with “public goods” characteristics. For private-goods-type services, a user fee is the best financing instrument for satisfying the principles of efficiency, accountability, transparency and fairness.⁹ This is no different from pricing a loaf of bread, a litre of milk, a movie ticket, a vacation, or any other good or service where the consumer or user can be identified, where income distribution is not an issue and where spillovers are not prevalent.

User fees currently fund some or all of the costs of a range of municipal services. Fees range from fixed charges that are unrelated to consumption, to charges that vary directly with quantity consumed, to a mix of fixed and variable charges. In addition, the pricing structure may cover all or only a portion of production and delivery costs. Decisions about pricing structures and the proportion of costs recovered from user fees depend on a variety of considerations. Local tradition, the type of service, the tastes or preferences of residents, and the willingness (or lack

thereof) of local politicians and administrators to substitute user fees (prices) for local taxes are all factors that affect the policy choices.

If properly designed, user fees take into consideration cost differentials attributed to economies of scale, capacity constraints, differential demand in peak and nonpeak periods, and the existence of spillovers (Bird and Tsiopoulos 1997; Dewees 2002; Kitchen and Tassonyi 2012). Ultimately, the objective in setting a fee should be to establish a clear link between those who receive the service and those who pay for it.

However, with the exception of utility services (for example, water and sewer services), many of which have full-cost pricing rates in several jurisdictions, current practice in setting user fees almost always deviates from that which is fair, efficient, and accountable. The tendency is to set fees to generate revenue rather than encourage a more efficient use of municipal resources. Failure to introduce efficiency considerations¹⁰ into the pricing structure or to entertain, in any serious fashion, suggestions for expanding the role for user fees has been defended on the grounds that they are regressive. This claim, however, is about as relevant as the claim that prices for milk and movie tickets are regressive. This is not to question the importance of income redistribution but rather to suggest that it should be handled through income-redistribution programs that target the poor rather than through distorting prices (lowering them so that they are less than the cost of the service consumed), which frequently benefits the wealthy more than the poor (Boadway and Kitchen 1999, chaps. 8 and 9).

Furthermore, failure to price with efficiency considerations in mind creates a good deal of unplanned and implicit income redistribution, much of which would be unacceptable if it were made explicit. For example, the tendency to charge a fixed price for water, regardless of quantity consumed — on the premise that fixed-income earners (the poor and seniors, perhaps) cannot afford to pay the full cost — provides an implicit subsidy for higher-income households with larger lawns to water and more cars to wash. Similarly, the practice of setting lower transit fares for all seniors, regardless of their income, provides an implicit subsidy to wealthier seniors. The practice of ignoring efficiency considerations in setting prices has led to a demand for services and, as a result, a demand for physical infrastructure that is not optimal (Kitchen 2006a, b). More specifically, inefficiently set user fees or tax rates have led to overuse, overinvestment and larger facilities than would be justified if more efficient pricing practices were adopted.

For services generating collective or “public goods” benefits to local residents, however, financing should come from a local tax. The strongest economic and fiscal arguments for such a tax come from the literature on fiscal federalism, in which there is widespread agreement on general principles that should be followed. In short, a limited tax base is prescribed for local governments (McClure 2001), with the best municipal or local taxes being those that have the following characteristics (Bird 2001; Bird and Bahl 2008; Inman 2005):

- ▶ They are based on an immobile tax base and therefore borne primarily by local residents (they are not exported).
- ▶ They do not create problems with harmonization or harmful competition among local governments or between local governments and more senior levels of government.

- They generate sufficient, stable and predictable revenues. They are visible, ensuring accountability and transparency.
- They are perceived to be fair and are relatively easy to administer locally.

The property tax meets these criteria better than any other tax (Slack 2011, 2013). Its tax base is largely immobile. Revenue is relatively predictable and stable in that it does not vary with cyclical swings in economic activity as much as personal-income- and consumption-based tax revenues. The part of the tax that is on residential property is unlikely to be exported. It is highly visible and fair as long as it covers the cost of providing those services that provide collective benefits to the local community. If the property tax is a local tax only (with senior levels of government not involved), harmonization problems and wasteful tax competition should not be a problem. A potential downside of the local property tax is that it may be more expensive to administer than other local taxes (income, sales or fuel, for example) that could be piggybacked onto existing federal or regional taxes. This, however, may be a small price to pay if local governments are to have autonomy and flexibility in setting tax policy — important ingredients of responsible, efficient and accountable local governments (Bird 2001, 3).

Finally, for services that have a mix of “private goods” and “public goods” characteristics, a combination of user fees and the property tax is appropriate.

What about grants?

There are two types of grants that municipalities receive from federal and provincial governments: unconditional and conditional. Unconditional grants come with no strings attached; that is, the funds may be spent on any service or in any way the recipient municipality chooses to spend them. They are generally given to municipalities that are deemed to have a weak revenue base and to be in need of external funds to meet expenditure commitments. As the next section shows, however, they are relatively unimportant in the overall revenue picture, although they may be important for a few very poor smaller municipalities.

Conditional grants, on the other hand, are almost entirely intended for infrastructure and come with strings attached; that is, they must be spent on specific projects. These grants are economically sound if the services or projects for which they are given generate spillovers, or are of specific interest to donor governments. Here, the best type is a conditional grant that provides partial or full funding, with the funding rate set to match the proportion of benefits that spill over to other jurisdictions or go to the donor government. These grants, however, often create problems. For example, they can distort local decision making. First, conditional transfers require municipalities to spend according to the guidelines of senior governments and often require matching funds on the part of the recipient municipality. This was evident in the recent stimulus grant funding program (Kitchen 2013a). Grants like this effectively lower the price of municipal services and encourage municipalities to spend more on these services than might otherwise be efficient.

Second, conditional transfers may encourage people to stay in communities at risk. Some small, rural and remote communities may be unable to provide adequate levels of service at reasonable tax rates (Kitchen and Slack 2006) or at reasonable user fees, and so they will require grants to

survive. This raises a question about using grants to artificially support remote communities where they would or should not otherwise exist.

Third, conditional transfers reduce accountability. When two or more levels of government fund the same service, accountability problems exist if users are not sure which level of government is responsible for the project. International experience tells us that governments are more likely to carry out their expenditure responsibilities in an efficient, transparent and accountable manner if they are also responsible for raising their own revenues (Bird 2001).

In short, the economic rationale in support of conditional grants — currently the most prevalent form of transfers to municipalities — is weak. Where they are provided, however, their acceptance should be conditional on recipient governments setting user fees and local taxes in an efficient and accountable manner. Failure to do this generally leads to underpricing and, consequently, an overuse of a service and overinvestment in infrastructure.

Revenue sources currently used

Table 3 records per capita revenues by source along with the relative importance of each source for Ontario municipalities for each year from 2009 to 2012. In 2012, own-source revenues accounted for slightly less than 79 percent of municipal revenue. Unconditional grants accounted for slightly more than 1 percent while conditional grants (most for infrastructure) accounted for 20 percent. The pattern was roughly the same in 2009 and 2011, but somewhat different in 2010, when conditional grants played a more important role, primarily as a result of the large infusion of federal and provincial stimulus grant funding (Kitchen 2013a). Overall, total revenues increased by almost 10 percent in current dollars and by slightly more than 7 percent in constant dollars from 2009 to 2010. This increase is mainly attributable to the stimulus grants. From 2010 to 2011, per capita revenues fell by almost 2 percent in current dollars and by almost 5 percent in constant dollars. From 2011 to 2012, the increase was 1 percent in current dollars with a decrease of 0.5 percent in constant dollars.

Property taxes and payments in lieu of property taxes, the largest single source of municipally generated revenue, accounted for almost 41 percent of all revenue in 2009 and 2012, and slightly less in 2010 and 2011. From 2009 to 2012, they increased at an average annual rate of 3 percent in current dollars (penultimate column of table 3) or 0.6 percent (final column of table 3) in constant dollars.

User fees, the second most important source of locally generated revenues, grew in relative importance over this four-year period. In 2009, they accounted for less than 19 percent of all revenues; by 2012, they accounted for more than 20 percent. On an average annual basis, they increased by 5.9 percent per year in current dollars or 3.3 percent in constant dollars. This increase is largely attributed to a growing number of municipalities that have moved to bag tags and tipping fees for solid waste collection and disposal; higher water rates for water and sewer infrastructure; increased public transit fares to cover a higher percentage of operating and capital costs; and additional charges for the use of recreational facilities and cultural institutions (museums, galleries and some library services) to cover a higher proportion of their operating

Table 3. Per capita revenues and average annual change in revenues, Ontario municipalities, 2009-12

Services	2009		2010		2011		2012		Average change	
	Per capita (\$)	% of total	Per capita (\$)	% of total	Per capita (\$)	% of total	Per capita (\$)	% of total	In current dollars (%)	In constant dollars (%)
Property taxes ¹	1,230	40.7	1,266	38.1	1,292	39.6	1,339	40.7	3.0	0.6
User fees ²	566	18.7	604	18.2	635	19.5	666	20.2	5.9	3.3
Licences, permits	75	2.5	80	2.4	80	2.5	83	2.5	3.5	1.0
Fines, penalties	46	1.5	44	1.3	44	1.3	45	1.4	-0.8	-3.0
Revenues from other municipalities	46	1.5	59	1.8	49	1.5	48	1.4	1.0	-1.3
Other ³	387	12.8	399	12.0	413	12.7	410	12.4	1.9	-0.4
Total own-source	2,350	77.8	2,453	73.9	2,512	77.0	2,590	78.6	3.4	1.0
Unconditional grants	63	2.1	54	1.6	48	1.5	46	1.4	-9.0	-10.7
Conditional grants	610	20.2	815	24.5	702	21.5	658	20.0	2.7	0.3
Total	3,022	100.0	3,321	100.0	3,262	100.0	3,294	100.0	3.0	0.6
Yearly change, in current dollars	-	-	298	9.9	-59	-1.8	32	1.0	-	-
Yearly change, in constant dollars	-	-	217	7.2	-151	-14	-14	-0.5	-	-

Source: Calculations by the author based on *Financial Information Returns: Municipal Performance Measurement Program*, Ontario Ministry of Municipal Affairs and Housing (<http://oraweb.mah.gov.on.ca/fir/welcome.htm>).

¹ Property taxes include taxes on real property plus payments in lieu of property taxes and business occupancy property taxes.

² User fees include water and sewage rates, transit fares, solid waste and tipping fees, recreation and library fees, and other specific charges for using a service.

³ "Other" includes development charges, developed land for residential and commercial properties transferred to municipalities, gaming and casino revenues, government enterprise revenues, investment income and a miscellaneous array of other revenue sources.

and capital costs. Licences, permits, fines, penalties and revenues from other municipal governments were relatively stable over the same period.

Unconditional grants are very small contributors to municipal revenues and have been falling in relative importance over the past few years. Conditional grants, by comparison, make a much more important contribution, accounting for 20 percent or more of revenues in each year. They are designed to fund approved municipal infrastructure, and their relative importance is largely a consequence of the recent recession, during which the federal and provincial governments provided a large injection of stimulus grants in addition to the annual gas tax transfers that municipalities receive from both the federal and provincial governments (about five and two cents per litre, respectively) (Kitchen 2013b).

Financing services for an aging population

The municipality's role in providing services for an aging population should be no different from its role in providing services for any segment of the population. As long as the services are what the residents want and as long as they fall within the legislative and jurisdictional responsibilities of the municipality, there is no reason why they should not be provided. As noted earlier, all services and programs that are redistributive or that generate spillovers should be the responsibility of the provincial or federal government. These include social services, social housing and land ambulance. Fortunately, in Ontario, funding of social services will be fully transferred to the province by 2019. Unfortunately, municipalities will still have considerable funding responsibility for social housing and land ambulance.

Services and programs that are basically determined by local preferences should be the responsibility of municipal governments. These include recreational and cultural programs and facilities, public transit, sidewalks and streets, police and fire protection and inspection, water, sewer and solid waste, recycling and so on. Furthermore, many of the services provided to accommodate an aging population can benefit all age groups. For example, walking, cycling and jogging trails benefit everyone. Low platforms on public transit buses and trains help the old, the disabled and young children alike. Enhanced and expanded recreational and cultural facilities and programs benefit everyone.

How should municipal services for seniors be funded?

An issue whose importance seems sure to increase, if it has not already done so, is the financing of services primarily used by seniors. For instance, recreational services tailored to the aged may not be seen as desirable if other age groups help fund these services or have to forgo services better suited to them. A similar comment can be made about public transit, for which seniors' fares are almost always discounted, meaning that other age groups who use the same service effectively subsidize the seniors. These examples illustrate the importance of examining the way in which services used by seniors ought to be financed.

Is there a basis for age-based property-tax and user-fee subsidies?

The practice of subsidizing municipal services by levying lower fees or taxes based strictly on age started in the 1960s and early 1970s, when a large percentage of seniors were living in

poverty. Recently, however, there has been growing discussion about a justifiable basis for continuing this policy.

User fees

Two potentially important problems emerge if seniors pay lower user fees than nonseniors for the same service. First, this is unfair because it leads to an implicit subsidy or redistribution of income from those paying higher prices to those paying lower prices (that is, from nonseniors to seniors), irrespective of income. Furthermore, wealthier users within the senior age group get the same subsidy as impoverished individuals (McMahon 2014; Taylor 2013).

Second, the practice of discounting user fees is inefficient because the group paying the lower price will not be covering the same share of operating and capital costs as the group paying the higher price. For those paying a lower percentage of costs, an incentive exists for overuse and overconsumption. This, in turn, often leads to a demand for more services and higher service levels than is economically efficient and, ultimately, more infrastructure investment than would be the case if every user paid the same price for the same service.

In the benefit-based model of municipal finance, which has been widely accepted as the basis for financing municipal services, these two problems can be minimized, if not eliminated, by structuring user fees so that they cover all operating and capital costs and are set at the same level for everyone, regardless of age.

Municipal property tax

Within the benefit-based model of municipal finance, residential property tax rates should be the same for all property types (for example, single-unit or multi-unit residential) that benefit from similar municipal services. These rates should not be, and currently are not, differentiated according to the age or income of the occupants or owners of the property. The residential property tax is based on assessed property. The rate is set so that it generates enough revenue to fund the cost of those municipal services that provide collective benefits to the local community. If the rate were differentiated to reflect the age of the head of household or occupant, for example, inequities and inefficiencies of the type described for differential user fees would be prevalent in this case as well.

School property tax

Most provinces have introduced a provincial property tax and justified its existence by claiming that it is used for partially funding elementary and secondary public schools. The monies, however, go into general provincial revenues and not into dedicated school funds. Newfoundland and Labrador is an exception in that it does not levy a provincial property tax to fund education. Manitoba is the only province where school boards set their own property tax rate for funding a portion of local education costs. Elsewhere, the province sets the education property tax rate (Kitchen and Slack 2014).

Since a public education system directly benefits its students and indirectly or collectively benefits all residents of the community, there is a basis for arguing that local residential property taxes should be used to fund a portion¹¹ of local public schooling costs (Auld and Kitchen

2006). This, however, has often been criticized by seniors' groups or organizations who assert that seniors should not have to pay the education property tax, presumably because they no longer have children in the public school system. In the context of funding public education, however, this criticism is flawed. As was argued earlier, property taxes should be used to fund services that provide collective benefits to the local community. Education does just that and as such it should be funded, at least in part, from property taxes on all residential properties, not just some residential properties. As well, if seniors are excluded from paying property taxes because they no longer have children in the system, should we not exclude all other property owners (young and middle-aged) who do not have children in the public system? Where do we start and where do we stop? Finally, if seniors were exempted from property taxes now, an inter-generational inequity would be created because previous generations of seniors paid property taxes to help fund public education costs of children whose parents are now seniors.

Should fees and property taxes for seniors be lower?

When lower fees and property taxes for seniors were introduced half a century ago, the federal and provincial governments were also concerned about high poverty rates among seniors, and introduced other programs to alleviate the problem. Among them was a publicly supported retirement security system made up of three components that still exist — the Canada/Quebec Pension Plan, Old Age Security and the Guaranteed Income Supplement. These programs have been widely praised as being responsible for lowering Canada's elderly poverty rate from 36.9 percent in 1976 to 3.9 percent in 1995 (Osberg 2001). By 2010, however, it had climbed back up to 12.3 percent (Conference Board of Canada 2013), primarily because of the slowed growth of government transfers to seniors (Murphy, Zhang and Dionne 2012). Despite this increase, the elderly poverty rate in Canada remains quite low compared with similar rates in Organisation for Economic Co-operation and Development member countries (Conference Board of Canada 2013; Statistics Canada¹²). Finally, the poverty rate for those over 65 in Canada in recent years has been considerably lower than for those under 65 (Citizens for Public Justice 2012). The generally lower incidence of poverty among the elderly provides little or no justification for continuing subsidies of whatever kind on the basis of age.

In a nutshell, services used by the aged should be financed in exactly the same way as services used by every other age group in the population, and property tax rates should not be age-based. Where user fees for services are applied, the practice of setting lower fares for seniors (for public transit and access to recreational and cultural facilities, to name two), or any other age group for that matter, should be discontinued. While politically popular for the beneficiaries of lower fees and charges, this practice is both unfair and allocatively inefficient (Kitchen and Lindsey 2013; Kitchen and Tassonyi 2012). It is unfair on the basis of benefits received because some users are paying a lower price than other users for exactly the same service, and also because the incidence of poverty is lower among senior citizens than among members of other age groups, who are otherwise subsidizing the discounted fees and taxes. It is inefficient, as noted earlier, because those who are subsidized have an incentive to demand and use more than they would demand or use if they paid the full price. This can be costly for municipalities if it leads to developing more services and more infrastructure than would otherwise exist.

The longer municipalities continue to subsidize services based on age, the more difficult it will be to correct this inequity and introduce more efficient pricing and taxing policies. Changing demographics suggest that seniors are becoming a stronger and stronger lobbying and voting group, thus making it more and more difficult for municipalities to correct past pricing distortions.

What is fair for seniors who are poor?

Setting user fees and property tax rates in a fair and efficient manner, as noted earlier, may mean that seniors who are poor could have considerable difficulty meeting their financial obligations. When these fees impose an unfair financial burden on low-income seniors, there are a couple of things that can be done. For services funded by user fees, one could offer lower fares on the basis of income, not age. Indeed, this has been recognized in recent initiatives in Hamilton, Windsor, Calgary, York Region and Kingston (and is being considered for Toronto), where affordable public transit fares based on income, not age, have been introduced (Kalinowski 2014). Policies like these are much better ways of redistributing income than simply offering reduced fares based on criteria, such as age, that are not based on ability to pay.

For services funded by property taxes, a number of provinces in recent years have introduced income-related property tax relief programs that are often available only for seniors.¹³ These include one or more of the following: property tax credit, property tax deferral, property tax exemption or grant (Kitchen and Slack 2014).

- In Prince Edward Island, senior citizens with an annual household income of \$35,000 or less may elect to defer 100 percent of property taxes. Deferred taxes must be paid when the property is sold or transferred to someone other than the owner's spouse.
- In Ontario, eligible seniors may receive a property tax grant of up to \$500. Municipalities also have the power to reduce, refund, cancel or defer residential and farm property taxes.
- In Nova Scotia, local councils may exempt certain persons from property taxation if their family income is below an amount specified by the local council. Eligible persons include those over the age of 65 and widows or single parents supporting dependents. A provincial property tax rebate program is also available for all seniors receiving the Guaranteed Income Supplement. Each recipient receives a rebate equal to 50 percent of the previous year's property taxes, to a maximum of \$600.
- In Manitoba, the province provides property tax relief to all residential homeowners through an income tax credit that diminishes in value as taxable income increases. The maximum value for the credit is higher for seniors. As well, seniors no longer need to pay the education portion of their property taxes.
- In Alberta, seniors may elect to defer their property taxes until they sell their home or die, at which point the back taxes plus interest must be repaid.
- In British Columbia, the Home Owner Grant program reduces property tax liability for owner-occupied principal residences. Homeowners who are 65 and older, permanently disabled, or veterans are entitled to an additional grant. There is also the Property Tax Deferral Program. This allows those who are 55 and older, surviving spouses and the permanently disabled to postpone payment of property taxes until the property is sold.

In short, income redistribution for seniors should be resolved in the same way as for the rest of the population. It should be addressed through income transfers from a senior level of government and social assistance programs targeted to all individuals in need. It is far more equitable to handle redistribution concerns through income transfers that target the poor than to tamper with fees or property taxes to accommodate these concerns (Boadway and Kitchen 1999).

Is there a role for grants?

A common assertion made by lobby groups and local politicians who advocate more and improved services for seniors is that federal and provincial governments should (or must) come to the table and provide grants to offset some or all of the costs. This assertion, however, must be treated with caution and, in many cases, skepticism. There are at least three points that can be made here.

First, when grants are used to fund (fully or partially) services for a specific age group, such as seniors, the tax rate or fee paid for the use of the service is lower than it would be if taxes or user fees were required to fund all service costs. As noted earlier, lower tax rates or fees create an incentive for users to demand or consume more than they would if they were required to cover the full cost of the service. Such overuse or overdemand, in turn, leads to more municipal resources being devoted to this service than is economically efficient. In the current fiscal environment, with municipalities having limited resources, overdemand or overprovision are not insignificant concerns.

Second, grants are not free money. They are generated from revenues, collected in the form of taxes or user fees from someone or some business, that are higher than they would be otherwise. This type of subsidization leads to concerns over who really benefits, because those paying higher taxes and user fees may be poorer than those who benefit from subsidized services. More directly, why should seniors who are wealthy be subsidized by younger taxpayers who are not as well off? At the same time, those paying higher taxes and/or fees may be further disadvantaged if they are required to work harder to make ends meet or to work longer if their business is to be successful.

Third, where there is a justification¹⁴ for using grants in funding municipal services, their use should be directed at services available for all age groups and not only those specific to seniors.

Should municipalities have access to additional taxes?

There is a substantial body of literature in municipal finance that supports the property tax as being a "good local tax." It is not, however, the only local tax used in a variety of countries (Kitchen 2010). Indeed, there are a number of arguments in support of giving large towns, cities, and regions access to additional taxes as a supplement to the property tax. Access to a mix of taxes would give municipalities more flexibility in responding to local conditions such as changes in the economy, evolving demographics and expenditure needs, and changes in the political climate (Kitchen and Slack 2003; Kitchen 2010). It would make the overall local tax structure more flexible, thus permitting municipally elected politicians to choose taxes that best suit local conditions and circumstances. For example, sales taxes might be chosen in situations where the benefits of local services are enjoyed by commuters and visitors.¹⁵ An employee-based

personal income tax (often referred to as a “tax on payrolls”) would tax commuters. Property taxes might be chosen where there is a need for a more stable revenue source.

The property tax is not an elastic source of revenue because it does not increase or decrease very quickly in times of economic growth or slowdown. Other tax sources, such as sales and income taxes, are more elastic and would allow municipalities to benefit from economic success (and share in economic failure). Access to additional tax sources would also mean that municipal governments would not have to implement large property tax increases, which is often cited by seniors as imposing an excessive burden on them. Furthermore, a single tax such as the property tax is almost certain to create local distortions, some of which could be offset by other taxes. For example, the property tax may discourage investment in housing. Income tax, on the other hand, may encourage investment in owner-occupied housing because the imputed income of such housing is not taxed. Having a number of different tax sources to rely on creates the possibility of distortions in one tax being counteracted by distortions in others.¹⁶

Conclusion

The current aging trend in Canada’s population has changed the way in which many municipalities are thinking about the provision of municipal services and their financing. This raises a number of issues: What should be the municipal role in providing services for an aging population? How should age-based services be financed — direct user charges, local taxes, grants or other alternatives? Is there a case for subsidizing municipal services that primarily benefit the aged? Should the aged pay lower user fees and property taxes for services such as public transit, libraries and recreational facilities? Should municipalities employ a range of new taxes or revenues to finance their services?

I have discussed these issues within a framework that argues for provincial policy and funding responsibility for services that generate spillovers or involve a redistribution of income. Municipalities should be responsible for services whose level and range can be determined by local preferences, such as neighbourhood parks, local streets and local sidewalks. With the exception of Ontario, the division of provincial and municipal service responsibility across Canada adheres closely to these principles. In Ontario, municipalities are responsible for a wider range of services, and they are also partially responsible for some income-redistributional services such as social assistance, social housing and land ambulance. Clearly, the guiding principles for a sound and solid municipal finance system argue that funding for these additional services should be the responsibility of the provincial and federal governments.

In Ontario, expenditures on transportation, protection, social services and environment account for over 70 percent of municipal spending. These are almost entirely financed from property taxes, user fees, and grants from both the provincial and federal governments. In principle, properly structured user fees are the ideal instrument for financing services, as long as specific users can be identified, the service generates few spillovers, and the service is not income redistributional in nature. Property taxes should be used to finance those services that provide collective benefits to the local community. Grants are appropriate for partial funding

of services whose benefits spill over into neighbouring jurisdictions or whose provision satisfies the donor government's goals.

Under this framework, services intended for the aged should be financed in exactly the same way as services for every other age group. The practice of setting lower fares for seniors for the same service should be discontinued. Funding practices like these mean that those paying a reduced price are effectively subsidized by those paying the higher price. Furthermore, those paying the lower price have an incentive to demand more of the service than they would if they paid the full price. This can lead to overuse of services and larger-than-required facilities — a costly outcome. Similarly, property tax relief programs should not be differentiated on the basis of property values or the age of the property owner, but rather on the basis of ability to pay.

Subsidizing services based on age means that wealthy seniors get the same subsidy as poorer seniors. User fees and property taxes can be regressive for all age groups, not just for seniors. Regressivity should not be addressed by artificially lowering prices or taxes. Instead, it should be addressed through income redistribution programs such as provincial transfers that target the poor regardless of age, and municipal property tax relief schemes that apply to everyone.

There is no more justification for providing provincial or federal grants to municipalities for services that benefit the aged than there is for providing grants for services benefiting other age groups. Grant funding means that users pay lower prices and/or taxes than they would if they were required to cover all service costs. Once again, this creates an incentive for users to overdemand or overconsume, which are serious concerns in the context of limited municipal resources. Grants are not free money. They are generated by revenues collected from taxes that must be paid by someone. Because of this, it is quite possible that grant-funded services have income-redistributional consequences that would not be acceptable if we actually knew who was paying those taxes.

Unlike municipalities in some countries, local governments in Canada have access to only one tax — the property tax. While this tax satisfies the principles of a “good municipal tax,” there are strong arguments for giving municipalities in Canada access to additional taxes. In particular, this could reduce some of the burden of the property tax on the poor, regardless of age. It would also alleviate a major concern about placing greater reliance on property taxes to fund additional services.

Economic arguments do not support the continued subsidization of services for seniors. Political pressure is another matter. Attempts to change pricing and taxation practices so seniors who benefit strictly on the basis of age pay more will almost certainly be resisted. Seniors are much better organized than any other age group and are becoming increasingly vocal in advocating for policies or perks for themselves. Clearly, the cost of funding such measures will increase in proportion to the growing size of this group.

Municipal governments have the power to change current pricing and taxation practices, but are they willing to make these changes? Failure to do so may have severe consequences in the not-too-distant future. Underpricing or undertaxing municipal services leads to overconsump-

tion and, in turn, to a demand for more infrastructure than is economically justified. This creates additional costs for municipalities, which must be covered by higher user fees and taxes. Where will the trickle-down effect stop? Higher prices or taxes for those who are not seniors mean that some taxpayers will struggle to make ends meet, and some businesses will not be able to survive in our increasingly competitive economy. These consequences are not desirable, and nor can they be supported in a solid and sustainable municipal finance system.

Appendix: Principles for Evaluating Financing Instruments

It is generally agreed that the benefits-based model of intergovernmental finance (see, for example, Kitchen 2008) is the most appropriate framework for evaluating municipal finance options. The underlying principle of this model (Duff 2004) is straightforward: those who benefit from municipal services should pay for them. The benefits-based model is particularly important because it satisfies the following municipal finance principles, thereby setting the stage for good governance (Kitchen and Lindsey 2013; Litman 2012): economic efficiency, leading to effective signalling; accountability; transparency; consistent and sustainable revenue yields; ease of implementation; ease of administration; and fairness or equity. Each of these criteria is defined here.

Economic efficiency is achieved when the user fee or price per unit of output equals the extra cost of the last unit consumed. This is the well-known price-equals-marginal-cost pricing principle. Charges or prices applied in this way are efficient for funding services for which the beneficiaries can be clearly identified and the costs correctly derived. Correctly set prices, in turn, send signals to policy-makers about the optimal level and quality of service desired.

Accountability is best achieved where there is a close link between the use of a service and the price or charge paid for its use.

Transparency is achieved when users have access to information on the way in which the price or charge is set, and the way in which expenditures are made.

Consistent, sustainable revenue yields are essential. A revenue source should be consistent in the sense that the yield does not fluctuate with the business cycle or other unforeseeable events. A revenue source should also be sustainable in that it does not shrink over time because of changes in technology or behaviour. Finally, a revenue source should produce a substantial yield.

Ease of implementation is important: A new revenue source should be technically feasible and economic to implement. The time and cost involved in implementation depends on whether new or unfamiliar technologies are required; whether legal barriers have to be overcome; whether new departments or institutions need to be set up; whether new communication links between existing institutions need to be established; and so on.

Ease of administration is desirable for any revenue source. It should be economical to operate, and also simple for users or taxpayers to understand and comply with in terms of payment or adherence to regulation.

Fairness or equity has horizontal and vertical dimensions. Horizontal equity is satisfied when individuals in similar situations are treated equally. Vertical equity concerns how individuals with different income levels or privileges are regarded. Horizontal equity is achieved when those who consume public services pay for them, just as someone who benefits from purchasing milk or a movie ticket pays for it. Concern about the burden on lower-income individuals is important, but it should not be addressed by altering or distorting the price or charge for a service. Doing

so undermines economic efficiency, as defined earlier, and raises the cost of administration. Furthermore, subsidization often benefits the rich more than the poor. Instead, vertical equity concerns should be addressed through income transfers from provincial or federal governments and social assistance programs targeted to individuals in need.

Notes

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- 1 Statistics Canada, 2014, "Population by sex and age group," CANSIM table 051-0001; and "Projected population by age group and sex," CANSIM table 052-0005.
- 2 Toronto is the only Canadian city that is exempt from borrowing limits (removed in 2007 under the *City of Toronto Act*). It should be noted that the population of Toronto exceeds those of five of the provinces of Canada, and so does its budget.
- 3 Municipalities have no control over assessment, however. This is a provincial responsibility everywhere.
- 4 In every province, municipalities have no responsibility for spending on elementary and secondary schooling.
- 5 It is not possible to apportion expenditures by age of user, hence specific expenditures on seniors' programs and needs cannot be identified.
- 6 See the notes below table 2 for a listing of the expenditures that constitute each spending category.
- 7 As noted earlier, Toronto is the lone exception in Canada.
- 8 This discussion does not examine the miscellaneous collection of these relatively small revenue sources.
- 9 See the appendix for a description of these principles.
- 10 The efficient setting of user fees (sometimes called "allocative efficiency") means that the user fee is equal to the marginal cost of the last unit consumed. See the appendix for more detail.
- 11 Provincial grants fund the remaining portion of public education costs.
- 12 Statistics Canada, 2014, "Population by sex and age group," CANSIM table 051-0001, and "Projected population by age group and sex," CANSIM table 052-0005.
- 13 Municipalities in every province also have the power to enact additional tax relief schemes to alleviate the burden on specific groups of taxpayers. These initiatives may include reductions, cancellations or refunds of property taxes.
- 14 Such a justification exists when the service creates spillovers, or when it exists to satisfy, or has to meet standards or conditions imposed by, donor governments.
- 15 Evidence from the United States suggests that the cost of inner-city services used by people who live in the suburbs and commute into the city centre to work exceeds, sometimes substantially, what they pay for inner-city services (Chernick and Tkacheva 2002). Local income and consumption-based taxes could be used to alleviate this disparity.
- 16 One study conducted in the United States (Mikesell and Mullins 2009) concluded that state-level reliance on local sales and income taxes that are one percentage point higher reduces the property tax burden relative to household income by 4 to 4.5 percentage points.

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