Funding a better future:

Progressive revenue sources for Canada's cities and towns

By David Thompson,
Greg Flanagan,
Diana Gibson,
Laleah Sinclair
and Andy Thompson.

CUPE

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About the authors

David Thompson is Principal at PolicyLink Research and Consulting, and Policy Director of the Sustainable Communities program at Sustainable Prosperity, University of Ottawa. He holds postgraduate degrees in law and economics.

Greg Flanagan is a public finance economist and was a teacher, researcher, and administrator, most recently at the University of Lethbridge (retired) for over 25 years. He holds degrees in economics and policy studies from the University of Calgary, York University, and the University of British Columbia.

Diana Gibson, M.A., is Principal at PolicyLink Research and Consulting, and President of Canadians for Tax Fairness. She was previously the Research Director at the University of Alberta's Parkland Institute, and a researcher for the Trade Union Research Bureau.

Laleah Sinclair, B.Soc.Sci., is a research contractor with PolicyLink Research and Consulting. She was previously a research assistant with Creative Neighbourhoods, and a fundraiser and supervisor with Public Outreach.

Andrew Thompson, Hons. BSc. is a research contractor with PolicyLink Research and Consulting. He was previously a research assistant at the University of Ottawa.

About this paper

The Canadian Union of Public Employees commissioned this document as a background research paper to survey the current state of municipal revenue sources and stimulate a deeper examination of, and focus on, municipal revenue-generating options that are fair and equitable. The paper is a discussion paper, and is not a reflection of CUPE policy.

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Executive summary

Canadian municipalities have limited revenues, but face growing responsibilities and costs. Municipalities need additional revenues to finance important public goods and services, and achieve other policy goals. The responsibilities of municipalities are increasing due to economic growth, offloading of services from other levels of government, environmental challenges and other factors.

There is recognition that new revenue-generating options should avoid being regressive – disproportionately hurting those with lower incomes – and should instead adopt a progressive structure that relies on those who are most able to pay. However, the literature on municipal revenue reform rarely provides a sustained focus on the impacts of various revenue-generating options on different income groups. This paper aims to spark much-needed discussion on the suite of available revenue options, their progressive or regressive impact on income and wealth, and the extent to which they could be designed to be fairer.

Taxes, spending and inequality

Municipalities collect approximately eight to nine per cent of all taxes collected by governments in Canada, down from 45 years ago when municipal taxes were 16.7 per cent of all taxes collected. Moreover, local government revenues have not kept pace with the economy. Instead, they have declined as a proportion of gross domestic product since 1961, dropping sharply since the early 1990s.

The largest revenue streams for municipalities are property taxes and user fees (fees from the sale of municipally-provided goods or services). These two categories have increased as a share of total municipal revenues over the last two decades, making up over 70 per cent of total revenues. The current reliance on property taxes and user fees is challenging for municipalities, as neither is indexed to economic growth, and both can be regressive. In contrast, the large majority of OECD member countries rely on a more balanced combination of income, sales, and property taxes to fund their municipalities.

Important drivers of increased municipal spending include: the infrastructure deficit caused by federal and provincial spending cuts in the 1980s and 1990s; the extensive and increasing impacts of climate change on infrastructure; demographic change; as well as economic growth and the demands it creates for services and infrastructure.

As in many other OECD countries, income inequality has risen in Canada over the last few decades, with only the richest increasing their share of national income. Independent of poverty, inequality is associated with many social problems, including poor education and health outcomes; lack of trust and reduced participation in community life; higher rates of addiction and obesity; and higher rates of violence and incarceration. Inequality is also a drag on the economy, reducing economic growth, efficiency, and productivity.

While federal and provincial taxes can be progressive overall, the heavy municipal reliance on property taxes and user fees means municipal revenues are regressive overall. However, while a revenue instrument may be mildly regressive, it could fund spending with social or environmental benefits that are progressive enough to outweigh the impact of the revenue instrument.

Municipal revenue sources

Municipal revenue-raising powers are provided and constrained by provincial legislation. In some provinces, municipalities have access to a relatively wide variety of revenue streams, while others rely more heavily on the property tax. Some larger cities have special statutes (often called "charters") that provide wider revenue-raising authority. This paper reviews a variety of existing revenue sources, including:

Property taxes and related taxes

In Canada, property tax revenues make up over 60 per cent of own-source municipal revenues (revenues raised by municipalities themselves, as distinct from grants and revenues shared by higher-order governments with municipalities). Property taxes are regressive, as lower-income families spend a much higher proportion of their income on property tax than higher-income families. Although the property tax is a tax on a type of wealth, it can be regressive in terms of overall wealth. The property tax doesn't tax financial assets, which tend to be held by the more affluent, and it applies to the total value of the property, not just the equity (people with lower levels of income and wealth tend to have higher mortgages proportionally).

The business property tax rate is often higher than residential rates, recognizing that business property taxes are income-tax deductible. A recent push to reduce business tax rates is narrowing this gap, making overall property taxes more regressive and heavier for local residents (business owners tend to be wealthier, and sometimes live in other jurisdictions).

A land transfer tax (LTT) is a tax payable on transfers of land ownership, based on a percentage of the property value. Most LTT rates in Canada are progressive in respect of the value of the property, ranging from zero to 0.5 per cent for low-value properties, to two per cent for higher-value properties. In addition, because the LTT is collected on land transfers, rather than ongoing ownership, it would tend to have a larger effect on those buying and selling properties more frequently, who are often higher income people.

User fees

User fees are charges levied for municipal goods or services. They are the second-largest municipal own-source revenue stream, after the property tax. User fees are sometimes charged for services that have broad positive social and economic benefits, such as public transit, health care, education, recreation, child care, and libraries. Attempting to fully recover the costs of providing these types of public services from users is administratively costly and penalizes lower-income people. However, some user fees can be designed to be less regressive.

Grants and revenue sharing

Higher orders of government have provided financial support to municipalities for many decades through grants and revenue sharing. Conditional grants designated for a specific purpose are much more common than unconditional grants, but don't necessarily address local priorities. Revenue sharing is a longer-term commitment of funding. Overall, the impact of grants and revenue sharing is relatively progressive: these revenue sources are funded largely by progressive income taxes (among other provincial and federal taxes), as opposed to regressive property taxes.

Consumption taxes

Consumption taxes come in two main categories: general sales taxes, and excise taxes that apply to particular items, also called selective sales taxes. American and European cities have access to sales taxes, and tend to rely less on property taxes than do Canadian cities.

Sales taxes place a higher burden on lower-income consumers, who tend to spend a higher portion of their income on goods and services and the sales taxes that apply to them. Some excise taxes apply to "luxury" items such as hotel accommodations. Other excise taxes can be levied on fuel, advertising, amusement, equipment, alcohol, tobacco and gaming. Fuel taxes, while regressive on their own, help reduce the human and economic costs of vehicle emissions, which can be very high, and disproportionately affect lower-income people. The substantial revenue from fuel taxes can be spent to provide an overall progressive effect.

Borrowing

Municipalities have a limited ability to borrow. The provinces generally disallow municipal borrowing to finance operating costs, and limit borrowing for capital costs. Municipalities can borrow on the general bond market, though government-facilitated financing facilities such as municipal financing authorities, revolving funds and infrastructure banks can offer better rates.

Gaming

Using casinos, slot machines and other gaming opportunities to raise revenues is tempting for municipalities, given that the revenues are high and the financial costs are low. However, lower-income people consistently spend proportionally more of their income on gambling than middle- and high-income people. Gaming leads to increased problem gambling, as well as small increases in crime and socioeconomic inequality.

Four revenue options and their relative progressivity

Together with the review of different revenue options, this paper provides added discussion of four revenue options, chosen because of their importance as existing or possible new municipal revenue sources, as well as their potential for making the overall revenue system more or less progressive.

Income taxes

The majority of developed-world municipalities have access to income tax revenues – a source of revenue that could significantly expand the fiscal capacity of Canadian municipalities and would increase with economic growth. Income taxes are generally progressive (marginal tax rates increase with income, while low- and no-income families are exempted from income tax), and are an important tool to reduce income inequality. Adding a municipal income tax to the federal or provincial income tax, or sharing a portion of those taxes (as the province of Manitoba does), would be more efficient to administer than municipalities collecting their own income taxes.

Local share of sales tax

Local sales taxes can also raise considerable amounts of revenue, while also ensuring non-residents pay for some of their use of municipal services and infrastructure. Adding on to existing sales taxes would be more efficient than direct municipal collection. While sales taxes on their own can have a regressive effect, they can generate billions of dollars to support public projects and services that have progressive impacts.

More progressive user fees

User fees can be designed to be more progressive, and to limit excessive consumption. Some regressive fees can be changed by adopting rates linked to consumption levels, while adding a “lifeline” zero-cost rate for modest levels of consumption (for example, for drinking water). Other techniques can also be used to reduce the regressivity of various user fees, including rebates, vouchers, and credits for lower income people. Such changes would not result in user fees that are progressive in the same manner as a progressive income tax, but they can make the suite of municipal fees less regressive.

Progressive property tax

Property taxes can be made more progressive in various ways. First, rates could be restructured by dwelling type, to provide lower rates for multi-family units, as some boroughs in Montreal have done (lower-income people tend to live more often in multi-family units, rather than single family homes). Property tax rates could be made higher for higher property values, much as income tax rates are higher for higher incomes. Restoring higher tax rates for business-owned property, and boosting the land transfer tax rather than the property tax, would make the overall property tax system more progressive. Finally, provincial governments can provide income tax credits to reimburse residents for a share of the property taxes they pay (a flat amount that phases out at higher income levels would be the most progressive).

Assessing the fairness of municipal revenue options

Emerging from the above discussion, a number of principles, or a "fairness screen" could inform analysis of potential revenue options:

1. Revenue sources with progressive impacts (such as a share of income taxes) should be used to displace revenue sources with regressive impacts (such as property taxes).

2. To the extent possible, municipally-controlled revenue sources should use rates tied progressively to income, wealth, consumption of luxuries, or other similar factors.

3. Where possible, basic consumption levels of essential goods and services should be exempt from user fees.

4. Where possible, revenues should come from taxing behaviours or goods that have harmful environmental or social impacts, rather than those with broad positive environmental, social or economic benefits.

5. Income-based tax exemptions, rebates and credits should be used to reduce the regressive impact of some taxes or fees and enhance progressivity.

6. In addition to analyzing new revenue options, existing revenue sources should be analyzed for their relative progressive or regressive impact.

7. Spending associated with a new revenue source (whether earmarked or simply established at the same time) should also be analyzed for its relative progressive impact. A somewhat regressive or neutral revenue instrument could be part of a larger policy initiative that includes a progressive spending element.

Conclusion

Municipal public services are both important and a great bargain for Canadians. Many of these services could not be purchased in the private market, and overall citizens save enormous sums by collaborating with their fellow citizens to "buy in bulk."

Canadians strongly support taxation to pay for municipal services, and particularly progressive taxation. Municipalities urgently need a wider range of revenue options. In assembling the revenue options that will enable future expenditures, municipal policy-makers will need to pay attention to the fairness and equity impacts of both the revenue sources they choose, and how that revenue is spent.

Introduction

Objective

The objective of this report is to promote a discussion of how municipalities can generate additional revenues to provide needed public services without worsening income inequalities.

There is growing recognition of the need for Canadian municipalities to have additional revenues to finance important public goods and services and achieve other policy goals. The responsibilities of municipalities are increasing, due to population growth, offloading of services from other levels of government, environmental challenges and other factors.

The need for municipalities to have additional revenues has been recognized by many organizations and experts in reviews published across the country:

"The municipal governments of Canada's major cities are caught in fiscal pincers: while bearing costs of services offloaded by federal and provincial governments, their share of overall government revenues in Canada is insufficient. Municipal governments obtain less than 12 per cent of the revenue pie and this share is declining. To succeed, cities need access to taxes that increase with economic growth."

– Conference Board of Canada, 2007

"As the size and scope of responsibility for cities has expanded to accommodate rapid urbanization and growth across metropolitan areas, ensuring that city-regions have the appropriate financial and governance arrangements to effectively and efficiently deliver services has become increasingly critical."

– Institute on Municipal Finance and Governance, 2011

"The funding gap reported by Canadian cities – the shortfall between needed infrastructure investments and the funding dollars available – remains very large. What is more, there is evidence to suggest that the gap continues to grow."

– Canada West Foundation, 2011b

Cities in other countries have access to a number of revenue sources that Canadian municipalities generally can't access, such as sales and income taxes **(see Table A)**.

Governments across Canada are currently considering a range of proposals for municipalities to obtain additional revenues, including a “penny tax,” fuel taxes, a share of income taxes, or other revenue streams. At the same time, there is recognition that additional revenues should be progressive and fair:

“Progressive taxation – not simply more taxation – is the key to the financial success of the provincial and municipal orders of government.” (Municipalities Newfoundland and Labrador, 2014).

Many revenue sources can disproportionately hurt those with lower incomes. A revenue source that applies equally to everyone across the board, like a flat-rate user fee, will tend to extract a higher proportion of income from those with lower incomes. This impact is termed “regressive.” In contrast, progressive taxes rely on those who are most able to pay. For example, progressive income taxes are positively correlated with income. The intent is that the proportion of income spent on taxes doesn’t overburden those with lower incomes, and that those who can afford to pay more do so **(see Figure 1)**. Canada’s progressive income tax exempts Canadians earning below a certain level from paying income taxes, and marginal rates rise for higher income brackets.

However, despite acknowledging the need to avoid hurting lower-income people, the literature on municipal revenue reform rarely provides a sustained focus on the impacts of various revenue-generating options on different income groups. More discussion is needed of the suite of revenue options, their progressive or regressive impact on income and wealth, and the extent to which they could be designed to be fairer.

Given the fiscal reality facing municipalities, as well as public opinion and expert commentary, it is reasonable to think municipalities will access additional revenue streams in the future. This will need to be done in a way that is equitable, and is understood by citizens. Otherwise, proposed new revenue sources could be politically unattainable and have harmful social consequences. Revenue options should be assessed by their progressivity, and implemented in a way that protects lower-income people.

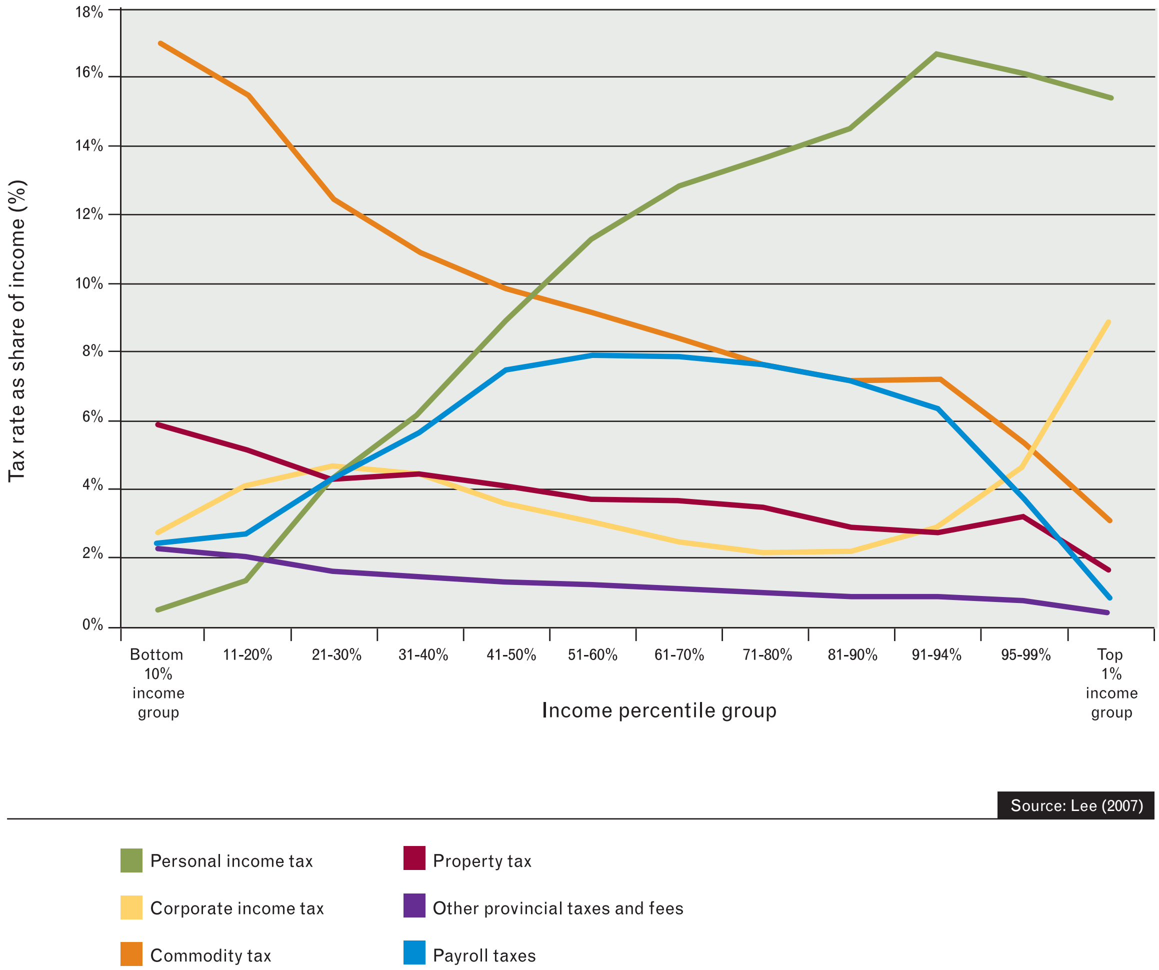
The next section of this paper reviews the need for fair municipal revenue options. Municipalities have limited revenues, and limited revenue-generating options, and face increasing responsibilities and rising costs. This section outlines the principles of good taxation, and explores Canadian social values like fairness, sharing, and equity, and support for progressive taxation. It then explores the basics of progressivity, how it is determined, and the benefit to Canadians. Appendices 1 and 2 provide further discussion of these issues.

The following section of of this report addresses the legal capacity of municipalities to adopt new revenue-raising options. It summarizes and assesses different revenue options in use, and potentially in use, for municipalities across Canada. It also reviews the problems with municipalities’ current heavy reliance on property taxes, and limited alternative sources. It examines some of the proposals for municipal revenue generation, and whether they would make the overall system more or less progressive. This section concludes with further assessment of four revenue options:

1. Income tax: giving municipalities a permanent, predictable share of provincial or federal income taxes. This would tie tax revenues to economic growth and be relatively progressive.

2. Sales tax: adding one percentage point to general sales taxes. This too would index tax revenues to economic growth. It would be regressive, but could be adjusted to be less so.

1 Tax rates by type of tax and income group (2005)



Source: Lee (2007)

3. Restructuring user fees: adjusting rate schedules for utilities and other services in a way that makes them less regressive and helps reduce over-consumption.

4. Restructuring the property tax: adjusting several features of property taxes, including the rates for different types of residences, and scaling rates to property values.

Finally, the paper concludes by reviewing key findings about the need for new and realistic revenues options, the importance of fairness in relation to revenue sources, and evaluation of potential new revenue options. It also points to some policy directions for developing a fairer overall tax system.

Need for fair revenue options

Limited revenues, but rising costs

Canadian municipalities have very limited revenue options compared with municipalities in other countries (Kitchen & Slack, 2003). They collect approximately eight to nine per cent of all taxes collected by governments in Canada (Federation of Canadian Municipalities [FCM], 2012c). This contrasts to 45 years ago when municipal taxes were 16.7 per cent of all taxes collected (Vander Ploeg, 2008b).

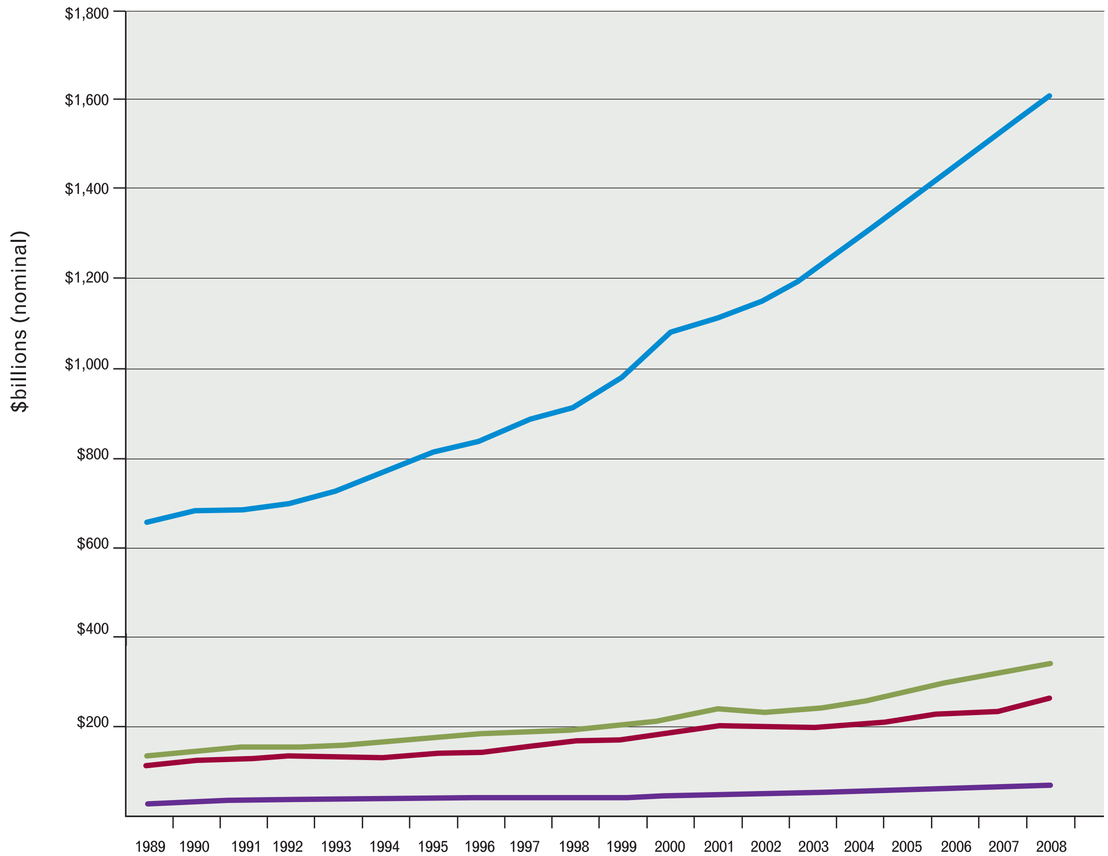
Transfers from higher orders of government have declined as well. Between 1988 and 2004, transfers dropped on average 3.7 per cent per capita each year (FCM, 2008b). Furthermore, the vast majority of senior government transfers (over 80 per cent) are conditional, and must be spent on specific projects (Statistics Canada CANSIM Table 385-0024).

Moreover, local government revenues have not kept pace with economic growth. Instead, they have declined as a proportion of gross domestic product (GDP) since 1961. They have also decreased relative to federal and provincial taxes. Since the early 1990s especially, revenues for all levels of government simply have not kept pace with Canada's growing economy **(see Figure 2)**.

"It is clear that local governments are collecting much lower levels of revenue in 2007 than at any point in the past 45 years." (Vander Ploeg, 2008b, p.15)

The largest revenue streams for municipalities are property taxes and user fees, which have increased as a share of total municipal revenues over the last 20 years. These two sources made up 71 per cent of Canadian municipalities' total revenues in 2008 (Statistics Canada, CANSIM Table 385-0024). The current reliance on the property tax and user fees is challenging for municipalities, as neither is indexed to economic growth. In contrast, income and sales tax revenues grow automatically with economic growth (as incomes and sales rise), with no need to adjust tax rates.

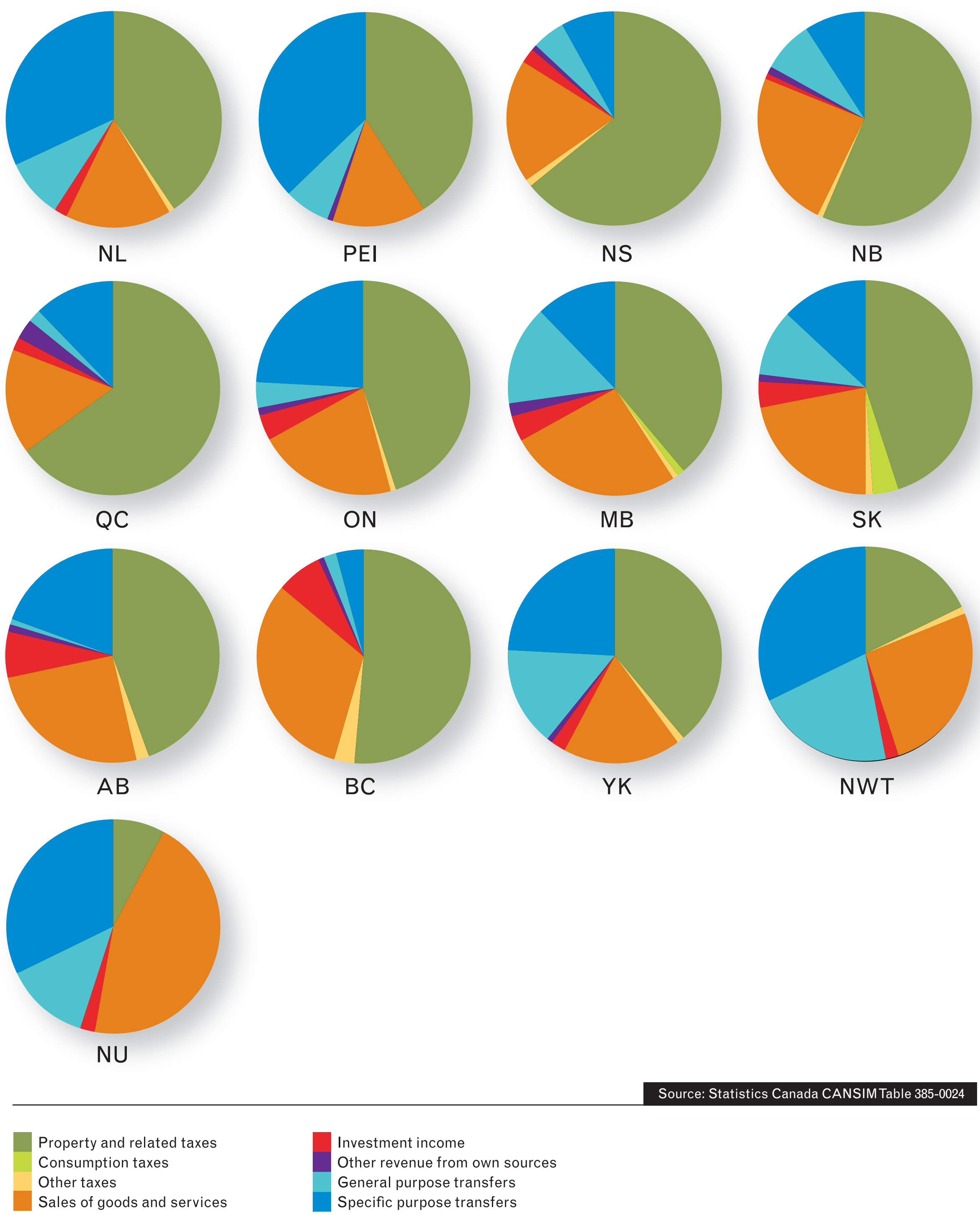
2 Annual government revenues and gross domestic product (GDP)



Source: Statistics Canada CANSIM Tables 380-0016 (GDP), 385-0001 (Government Revenues)

- GDP
- Federal
- Provincial and territorial
- Municipal

3 Municipal revenues by province and source (2008)[1]



[1] 2008 is the year for which the most recent reliable data were available.

Most developed countries do not rely as heavily on property taxes as Canada (and other British Commonwealth countries). The large majority of OECD countries rely on a more balanced combination of income, sales, and property taxes to fund their municipalities.

Table A

The international context: Canada's high reliance on property taxes

Percentage of total local tax revenue by source - OECD countries[2]

Country	Property tax	Income, profits, capital gains tax	General sales tax	Specific sales tax	All other taxes
OECD + Commonwealth					
Australia	100.0	0.0	0.0	0.0	0.0
Ireland	100.0	0.0	0.0	0.0	0.0
United Kingdom	100.0	0.0	0.0	0.0	0.0
Canada	97.9	0.0	0.2	0.1	1.9
New Zealand	91.3	0.0	0.0	0.6	8.0
OECD Only					
Israel	95.2	0.0	0.0	0.0	4.8
Mexico	89.0	0.0	0.0	1.6	9.4
Greece	78.6	0.0	3.2	14.9	3.2
United States	73.4	5.2	10.5	4.6	6.2
France	64.5	0.0	0.0	21.7	13.8
Belgium	53.2	36.7	0.0	6.1	4.1
Czech Republic	51.5	0.0	0.0	1.2	47.3
Slovak Republic	50.8	0.0	0.0	2.1	47.2
Netherlands	47.6	0.0	0.0	1.5	50.8
Korea	45.2	15.4	5.5	14.8	19.2
Chile	40.3	0.0	0.0	16.5	43.3
Spain	35.9	20.6	16.0	7.5	20.0
Portugal	34.2	34.6	12.5	8.5	10.2
Japan	30.9	48.6	7.7	6.5	6.3
Poland	29.6	58.2	0.0	0.0	12.2
Iceland	20.6	77.4	0.0	0.0	2.0
Hungary	19.8	0.0	67.9	0.9	11.3
Germany	15.8	78.1	5.0	0.5	0.5
Austria	15.4	0.0	0.0	4.4	80.1
Slovenia	15.1	78.4	0.0	3.5	2.9
Turkey	14.7	24.5	25.0	22.8	12.9
Switzerland	14.4	84.3	0.0	1.1	0.2
Italy	10.9	25.0	6.1	11.9	46.1
Denmark	10.8	89.0	0.0	0.1	0.1
Norway	10.1	88.5	0.0	0.0	1.4
Estonia	7.9	89.6	0.8	0.4	1.3
Finland	6.3	93.6	0.0	0.0	0.1
Luxembourg	6.0	92.2	0.0	1.2	0.6
Sweden	2.6	97.4	0.0	0.0	0.0

Source: Organisation for Economic Co-operation and Development (2010)

[2] This table includes tax revenues only - user fees and transfers are not included.

Taxes and user fees: differences and similarities

In addition to transfers from other governments, municipalities have two other major categories of revenues: taxes and user fees (the latter are sometimes termed charges, or revenues from sales of goods and services). User fees are sometimes used as an alternative to taxation, but they can be a regressive alternative. It is useful to understand the theoretical distinctions between these two major revenue categories, but also to know that in practice those distinctions are inconsistent and there is considerable overlap.

- In theory, user fees apply to users of specific goods and services, and so sometimes can be avoidable. However, some user fees are mandatory (e.g. waste collection fees, water supply fees), and some taxes can be avoided by not consuming the item being taxed, e.g. fuel taxes and other excise taxes.

- User fee revenues generally are described as paying for the specific goods and services provided, instead of supporting government more broadly. However, the "benefit principle" argues that taxes should pay for value received, and taxes are sometimes "earmarked" for spending in the same area where the revenue was generated (e.g. fuel taxes). In addition, user fees sometimes go directly into a consolidated revenue fund for general spending (e.g. under *Ontario's Financial Administration Act*).

- Taxes require legislative authority to be levied. However, user fees also require legislative authority, but the legislation is often more general in nature.

- User fees are meant to recover the costs of providing the goods and services. However, they often fail to do so (Ontario Auditor General, 2009).

Some or all of the above factors can be used to characterize a particular revenue instrument as a tax or a user fee, but in essence, taxes are an exercise of a governance power, while user fees are more akin to obtaining a price for selling a good or service. Both raise revenues.

Rising municipal responsibilities and costs

While municipalities have limited revenues that for the most part don't automatically increase with economic growth, they also face rising responsibilities and costs.

Provincial and federal governments engaged in severe cost-cutting in the 1980s and 1990s. At the same time, downloading of responsibilities such as the provision of social services increased costs for municipalities. Between 1998 and 2008, municipal spending across Canada on social services and housing increased by 2.5 per cent and 5.4 per cent per year respectively, compared to their overall spending increases of 1.4 per cent annually, after accounting for inflation (FCM, 2012c). For example, federal and provincial governments downloaded the work (and cost) of immigration settlement (Slack 2005, p. 4), especially in Ontario where municipalities are mandated to provide housing to newcomers (FCM, 2011b, p. 2). The operation of policing systems has also been downloaded (FCM, 2013, p. 24), with municipalities now paying two thirds of the total salary costs for police officers (FCM, 2012c). Overall, local government responsibilities and costs have risen, without commensurate dedicated funding to support the services provided (FCM, 2013, p. 24).

Federal and provincial governments have also mandated that municipalities meet certain requirements (e.g. drinking water and wastewater quality standards), but have not always provided the funds to support them. For instance, the *Canada-wide Strategy for the Management of Municipal Wastewater Effluent* initiative was put forward without funding from senior governments for the estimated $10 billion minimum it will cost municipalities to comply (Union of British Columbia Municipalities [UBCM], 2011; FCM, 2011a).

The housing market is another area where the federal government has decreased its role, but provides funds in a way that makes planning difficult. Federal funding for municipal housing projects is short-term and more conducive to band-aid approaches, rather than supportive of sustainable, long-term planning. Short-term funding also makes it difficult to procure volunteer and community support (FCM, 2013, p. 25).

Downloading in Ontario is another example. Between 1995 and 2004, the Ontario government shifted the responsibility for property assessment, airports, ferries, GO transit, municipal transit, and social housing to municipalities. There was no corresponding increase in control over public policy and standards, and grants to municipalities decreased during the same time period (Lidstone, 2004). In the same timeframe, the province of British Columbia "eliminated municipal taxation on railways and confiscated revenues from speeding ticket fines" (Lidstone, 2004).

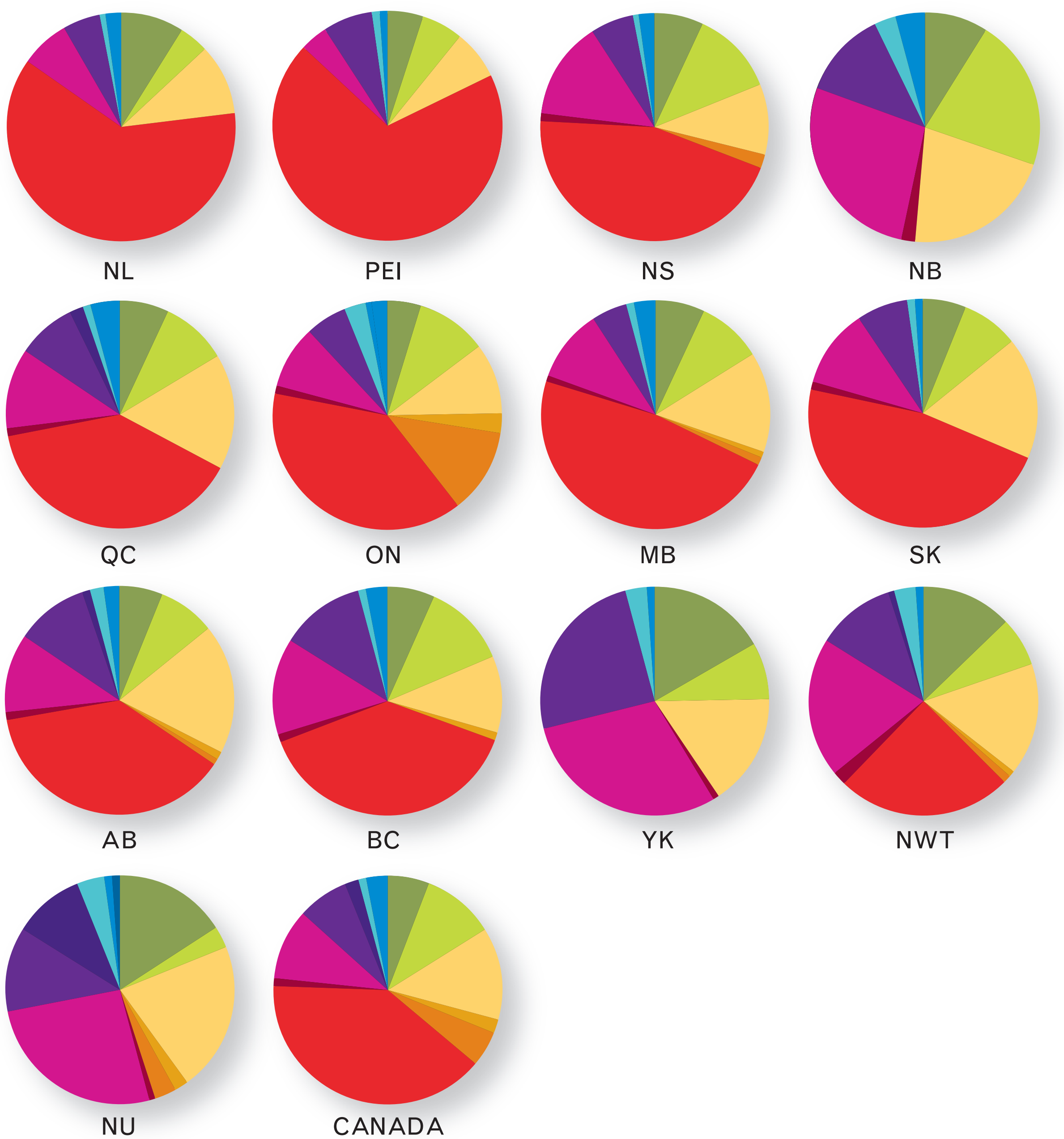
What do local governments spend their revenues on?

Major areas of spending for local governments across Canada vary, depending on their responsibilities. The largest single area of local government expenditures across Canada is education, which can include municipal and local school board spending, but the share borne by local governments can vary widely by province and territory **(see Figure 4)**. Other significant areas include transportation and communication; environment (including water purification and supply, sewage collection and disposal, and garbage and waste collection disposal); protection of persons and property (including policing, firefighting, and regulatory services); and recreation and culture. In some provinces, municipalities also spend considerable amounts on health care, social services, and housing, which have traditionally been the responsibility of provincial governments.

Looking at the services provided, the overall impact of municipal spending is likely significantly progressive – the benefits are more important to those with lower incomes. Reducing municipal spending across the board would have a regressive impact.

Municipalities face the high costs of maintaining and rehabilitating a significant amount of infrastructure, and municipal governments own an increasing proportion of Canada's public infrastructure. The share of net capital stock (the value of fixed assets) that municipalities are responsible for has more than doubled since the 1950s **(see Figure 5)**.

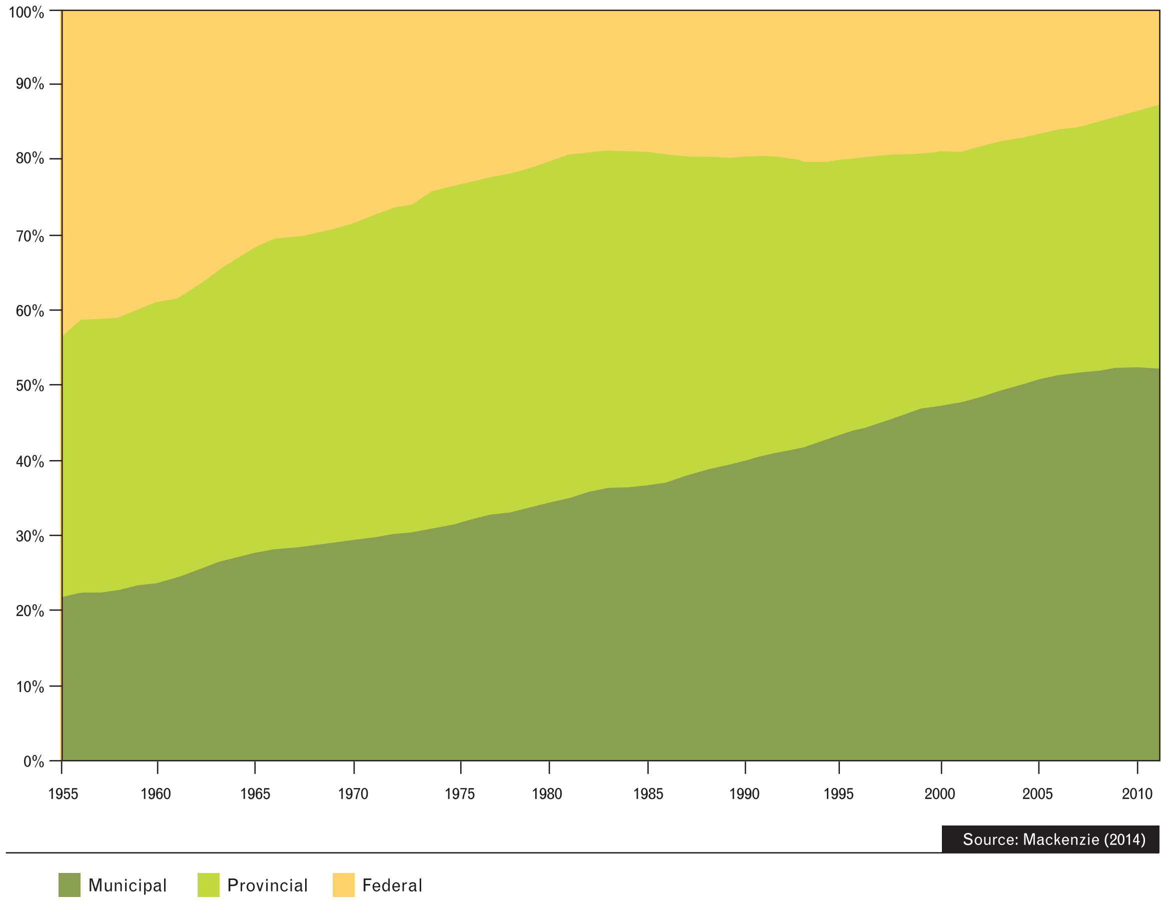
4 Municipal spending by province and area (2008)



Source: Statistics Canada CANSIM Table 385-0003

- General government services
- Protection of persons and property
- Transportation and communication
- Health
- Social services
- Education
- Resource conservation and industrial development
- Environment
- Recreation and culture
- Housing
- Regional planning and development
- Debt charges
- Other expenditures

5 Government shares of net capital stock (1955-2011)



Source: Mackenzie (2014)

In addition to the expansion of infrastructure required by growing municipalities, much of Canada's existing municipal infrastructure needs repair, maintenance or replacement. The shortfall between municipal budgets and infrastructure costs for the next decade is in the tens of billions of dollars. For just the seven largest western cities in Canada it amounts to over $40 billion (Canada West Foundation, 2011b), and stands nationally at $171.8 billion (FCM, 2012a). Some of the infrastructure that weighs on future municipal budgets was funded by matching grants from higher levels of government. These funds are allocated through applications, encouraging the development of projects based on their likelihood of success in the selection process, and not necessarily on their local importance (FCM, 2013, p. 24). In addition, grants are often driven by short-term goals and do not align with municipal planning needs that typically extend 10 to 20 years or longer. Nor are funds always available when it comes to the less photogenic business of maintaining and repairing the same infrastructure down the road. Those rehabilitation costs can be enormous (Thompson, 2013, p. 5).

Climate change and municipal budgets

The world's climate system is changing. In Canada, the average temperature increased by 1.3 C between 1948 and 2007, and precipitation rose by an average of 12 per cent (McBean, 2012, p. 5). These changes have serious side effects, as warmer temperatures create more violent weather patterns. Extreme weather events such as floods, droughts, and storms are rising in frequency and severity in Canada (McBean, 2012).

With increases in extreme weather events comes increased financial costs – nine Canadian disasters have caused over $500 million each in damage in the past ten years alone (Hildebrandt, 2013). In Canada, flooding and forest fires are projected to become even more frequent over the next 40 years (McBean, 2012). Municipalities will shoulder the financial cost of many such events because they are responsible for the largest share of Canada's public infrastructure. A related climate change impact, melting permafrost in Northern communities, has already resulted in massive costs to repair damage to buildings for Canadian municipalities (FCM, n.d.).

Municipalities are facing the costs associated with reacting to a changing climate that fall on municipalities, as well as the costs of preparing for further climate change. Coastal communities, such as Richmond and Delta in British Columbia, are being forced to look at the costs of protecting properties from rising sea levels. A 2011 B.C. government report warned builders and developers to plan for a one-meter rise in sea level within the next 90 years. (CBC News, 2012).

In July 2013, massive flooding overwhelmed Toronto's aging combined sewer system, releasing sewage and stormwater overflow – including solid human waste – into lakes and rivers. Sewage overflows pose a health threat to people swimming in Lake Ontario, and can cause infections and increased trips to the hospital (Powers, 2013). Toronto is investing $680 million to reduce the number of combined sewers in its downtown core, but smaller municipalities with fewer revenue sources will need help from upper levels of government to deal with the rising costs of climate change (Powers, 2013).

Economic growth itself also brings higher costs, requiring more municipal spending on both infrastructure and services. Growth outside of a municipality also imposes increased costs on the municipal government, as some of the people and businesses using urban services and infrastructure do not pay taxes to the municipality.

Smaller communities face even greater challenges. Analysis in Newfoundland and Labrador found that smaller communities (fewer than 5,000 people) have below-average per capita revenues. Because smaller communities have more difficulty generating own-source revenues, they depend more on provincial and federal grants. The fiscal stress on small rural communities is compounded by out-migration, an aging population, and lower levels of economic activity and employment. Many smaller communities require long-term government assistance to survive (Locke, 2011, p. 23).

Municipalities of all sizes are hemmed in by a combination of limited overall revenues, significant costs and spending pressures, and legal limitations on revenue sources available to them. In order to continue providing services that citizens want, municipalities will need to find additional sources of revenue. An important question is whether they can access revenue sources that are progressive – that don't hurt lower-income people.

Taxes and inequality

As in many other OECD countries (OECD, 2011), income inequality has risen in Canada over the last few decades: "only the fifth quintile – the group of richest Canadians – has increased its share of national income. All other quintile groups have lost share" (Conference Board of Canada, 2013). Even after income tax, the richest 20 per cent of Canadians earn over nine times more than the poorest 20 per cent (Statistics Canada, CANSIM Table 202-0703).

Concerns over income inequality go well beyond the issue of poverty or low incomes. There is a broad and robust body of research on the impacts of inequality, per se, on both social and economic well-being. On the social side, the flagship study *The Spirit Level* (Wilkinson & Pickett, 2010) examined inequality both between and within rich and poor countries. Their data shows a strong correlation between higher levels of inequality and a broad range of measures of social problems including poor education and health outcomes; lack of trust and reduced participation in community life; higher rates of addiction and obesity; and higher rates of violence and incarceration.

There is also growing evidence from international economic research that high levels of inequality can have a harmful impact on the economy (Conference Board of Canada, n.d.). Recent work by International Monetary Fund researchers examining factors in the duration of growth identified equality of income distribution as the factor most significantly correlated with longer-term economic growth (Berg & Ostry 2011). According to Nobel Prize-winner Joseph Stiglitz, author of *The Price of Inequality* and former chief economist at the World Bank, inequality results in more instability, lower economic growth, less efficiency, and less productivity. In a nutshell, too much inequality is bad for the economy (Stiglitz, 2012). The International Monetary Fund has proposed that nations increase taxes on high incomes and wealth, and has also published research showing higher taxes on the rich don't harm economic growth (International Monetary Fund [IMF], 2013; Ostry et al., 2014).

There are two categories of remedies for income inequality: those that support more equal incomes before taxes; and those that use the taxation and benefit system for redistribution (The Equality Trust, 2013). Municipalities can act in both areas. In addressing pre-tax income inequality, municipalities can adopt living wage policies (Centre for Civic Governance, 2011), eliminate outsourcing of services to low-paying firms, and support unionization, which is associated with higher levels of equality (Jackson, 2013). Municipalities can also enhance equality by making their overall taxation system more progressive.

"Taxes and transfers have a significant redistributive impact. Inequality in income after taxes and transfers, as measured by the Gini index,[3] *was about 25 percent lower than for income before taxes and transfers on average in the OECD area in the late 2000s. For the same period, poverty measured after taxes and transfers was 55 percent lower than before taxes and transfers for the OECD average."*
(Joumard et al., 2013)

As discussed in greater depth below, the two largest own-source revenue streams for municipalities – property taxes and users fees – are often quite regressive. Making the overall municipal tax system more progressive could be accomplished by redesigning those two sources to be more progressive, and by diversifying the system to include more progressive revenue sources.

Policy competition: the race to the bottom

One of the challenges in setting municipal taxation policy is the potential for policy competition between neighbouring municipalities. Some believe reducing tax rates helps lure businesses to their regions. The evidence suggests they are mistaken in that belief. Changes in local tax rates appear to have at most a small impact on business location, even over a period of several years (Smart, 2012). Moreover, there is evidence of harm caused by local tax competition.

In the United States, an extensive investigation by the *New York Times* found that local and state incentives for businesses amount to over $80 billion a year. Yet there is very little evidence of them having positive benefits in terms of additional jobs and economic activity. Instead, competition over business and tax incentives have led to a race to the bottom, with local and state governments outbidding each other but ultimately all losing out on tens of billions in foregone revenues from tax and other incentives used to attract businesses. This has led to public spending cuts in other areas, such as infrastructure and education, which can have a much more beneficial impact on a region's competitiveness (Story, 2012).

In order to reduce beggar-thy-neighbour tax policy competition between municipalities, upper levels of government can provide a greater share of tax revenue to municipalities, create regional systems of governance and cooperation, and limit reductions of service or taxation levels from historical averages.

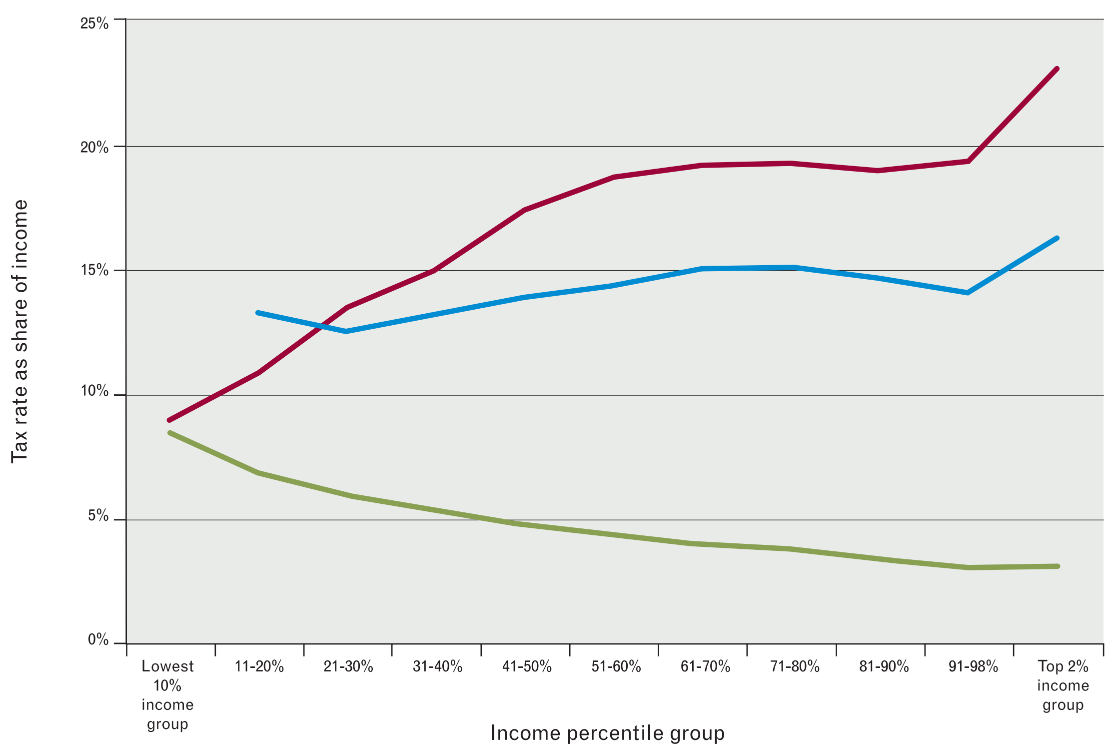
[3] For background on the Gini index/coefficient, see: World Bank, n.d.

Progressive revenues and progressive spending

Canadian municipalities first gained the power to levy taxes and enact bylaws in 1849. From the 1920s to the 1960s, municipalities enjoyed an increase in provincial funding that went hand-in-hand with increased provincial regulation. In the 1970s, funding increases were slowed by talk of municipal reform (Sancton, 1999).

While federal and provincial taxes can be progressive overall, municipal revenues are generally regressive with respect to income, as a result of their heavy reliance on property taxes and user fees **(see Figure 6)**.

6 Effective tax rates by level of government and income group (1988)



Source: Vermaeten (1995) p. 342-343

- Federal taxes
- Provincial taxes
- Municipal taxes

Since 1990, Canada's overall tax system has become more regressive, with cuts to taxes on business, high incomes, and income from capital, as well as increased reliance on property taxes and user fees. By 2005, the richest one per cent paid a lower overall rate of tax (as percentage of income) than all other income groups, including the poorest 10 per cent (Lee, 2007).

When the impact on public spending is considered, it becomes clear that the tax changes made since the 1990s have not benefitted the majority of Canadians. Had provincial governments invested in health care and education rather than cutting income taxes in the late 1990s and early 2000s, 75 per cent of Canadians would be better off (Mackenzie & Shillington, 2009, p. 22).

"Tax changes at all levels of government in Canada since the early-1990s have delivered virtually no benefit to most Canadians. They have delivered substantial benefits to those Canadians at the top of the income scale. And they have transformed a mildly progressive tax system into a regressive one. Thanks to the tax cuts of the 1990s, the tax system is now no longer alleviating relative market income inequality in Canada – it is exacerbating inequality." (Mackenzie & Shillington, 2009, p. 20).

Impact of spending

While this paper is aimed at municipal revenues, it is important to bear in mind that revenues are only half of the fiscal system. The spending side also has a distributional impact. Even when the revenue side is regressive, the overall impact of the system could be progressive. Likewise, a new revenue instrument being proposed could be mildly regressive in impact, but fund spending that is progressive enough to outweigh the impact of the revenue instrument.

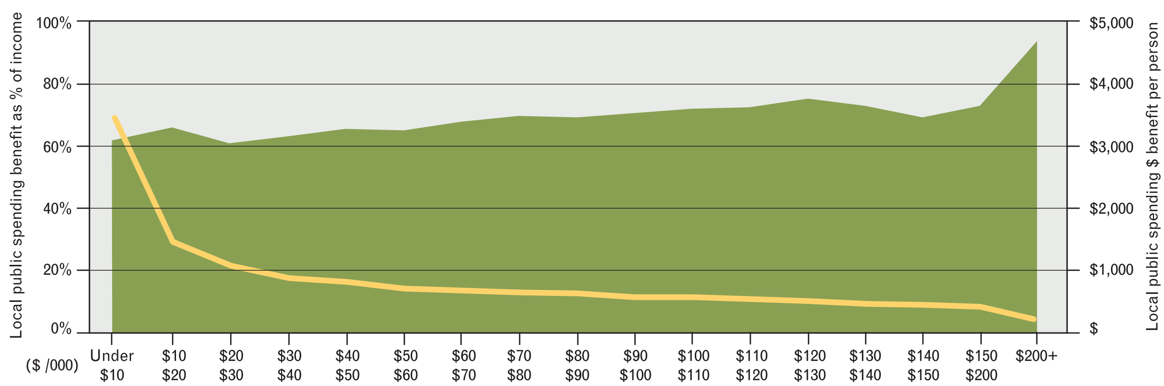
A study of the benefits of public spending found that "for the vast majority of Canada's population, public services are, to put it bluntly, the best deal they are ever going to get" (Mackenzie & Shillington, 2009, p. 3). The services funded by tax revenues have enormous economic (as well as social) benefits. The cost of those services to Canadians, if they were not publicly funded, would be more than half the total household income for the majority of Canadians (more than two-thirds).

"In other words, the tax cuts made to sound like free money to middle-income Canadians are anything but. Indeed, the tax cuts implemented in Canada in the last 15 years have had the net effect of reducing the living standards of most Canadians." (Mackenzie & Shillington, 2009, p. 6)

When it comes to local government spending, the impacts are different from spending at provincial and federal levels. For some municipal services, consumption increases with income, and thus the benefits provided by those services rises with income. Higher-income parents in Canada tend to have more children, and public elementary and secondary schools will thus provide them with more benefit per capita (Mackenzie & Shillington, 2009). This is why the per capita spending of local governments tends to be higher on higher-income households. Yet when viewed as a proportion of income, we see that public spending is a powerful force for redistribution of wealth in Canada (Mackenzie & Shillington, 2009, p. 15).

The green in the graph on the next page **(see Figure 7)** illustrates local government spending as benefits received by households. The amount of public spending on services ranges from $3,095 to $4,710 and generally increases with income. The yellow line, indicating benefits received from municipal services as a percentage of income, shows how local government spending can still have a redistributive effect, with the lowest income earners benefitting the most.

7 Per capita benefit from local public spending by income group



Source: Mackenzie & Shillington (2009)

Dollars of local public spending per capita (right axis)

Public spending as a percentage of income (left axis)

Support for progressive taxation

Governments have considerably reduced effective tax rates of the richest one per cent since the 1990s (Lee, 2007). Public awareness of this is increasing, and further moves in this direction may be politically constrained, because Canadians strongly support progressive taxation. Public opinion research has found that “a large majority (82 per cent) agree that ‘governments in Canada should actively find ways to reduce the gap between wealthy people and those less fortunate’” (Adams, 2013, p. 57). Fully 83 per cent of Canadians are in favour of increasing income taxes on the highest-income earners (Environics Research, cited in Broadbent Institute, 2012).

An Ipsos Reid poll found consistent results: 88 per cent of Canadians feel “the rich should pay more taxes,” with only 12 per cent disagreeing. This support was consistent across the country, with the lowest level of support in any province being 82 per cent. Support was also strong across all income levels, with the lowest level of support being 72 per cent among those with household incomes over $100,000. Of those surveyed, 89 per cent supported an additional tax on family income over $1 million per year. (Ipsos Reid, 2013).

This strong public support for progressive taxation is not lost on municipal officials. A 2010 study showed that the majority of B.C. mayors, councillors, and municipal staff agree they should structure their tax policy “through the lens of tax fairness for lower-income people,” outnumbering those who disagree by 3:2 (Fletcher & McArthur, 2010). Municipal officials would be wise to facilitate a public discussion of the progressive impact of revenue options, and to heed the public’s wishes.

For a further discussion of this topic, **see Appendix 1.**

Municipal fiscal capacity

Legal capacity

Unlike federal and provincial governments, municipal governments have no independent authority under Canada's constitution. Municipal governments are often termed 'creatures of the provinces,' and are literally created by provincial legislation. The provinces thus control municipal governments – what they can do, what bylaws they can pass, what revenue sources they can access, and what those revenue sources can look like.[4]

Access to revenue sources for municipalities differs by province. In some provinces, municipalities have access to a relatively wide variety of revenue streams, while many rely more heavily on the property tax. Property tax rates vary across jurisdictions, as do federal and provincial grants. For instance, municipalities in B.C. receive less grant income than other provinces, and those same municipalities provide a more limited range of services than municipalities in other provinces, especially Ontario (British Columbia Ministry of Community, Sport and Cultural Development, 2012, p. 5).

Each province has a core municipal government statute that addresses a wide variety of municipal governance issues (some provinces and territories have separate acts for each type of municipality). These statutes are:

British Columbia
- *Local Government Act*
- *Community Charter*

Alberta
- *Municipal Government Act*

Saskatchewan
- *The Municipalities Act*
- *The Cities Act*

Manitoba
- *Municipal Act*

Ontario
- *Municipal Act*

Quebec
- *Municipal Code of Quebec*
- *Cities and Towns Act*
- *Municipal Powers Act*

New Brunswick
- *Municipalities Act*
- *Community Planning Act*

Nova Scotia
- *Municipal Government Act*

Prince Edward Island
- *Municipalities Act*

Newfoundland and Labrador
- *Municipalities Act*

Yukon
- *Municipal Act*

[4] For a discussion of the primary revenue-raising powers in individual local government statutes, see D. Lidstone (2004), s. 2.7, "Delegation of Adequate Financial Resources," and particularly ss. 2.7.3–2.7.16; and D. Lidstone (2013), *Municipal Revenue: Partnerships and New Resources*.

Northwest Territories

- *Cities, Towns, and Villages Act*
- *Hamlets Act*

Nunavut

- *Cities, Towns, and Villages Act*
- *Hamlets Act*
- *Settlements Act*

In recent years, provincial legislation has tended toward more generous allocation of administrative powers to municipalities (Lidstone, 2004). These provisions haven't necessarily expanded taxation powers, but they may indicate a willingness among some provincial governments to expand municipal authority more generally.

In addition to the general municipal statutes, there are more specific provincial statutes that provide and limit municipal authority over various matters, including revenue sources. For example, in Ontario, the *Development Charges Act* governs how municipalities can gather revenues to offset some of the significant infrastructure and services costs they face when new subdivisions are built.

Finally, some larger municipalities have additional powers given to them by special statutes, sometimes called charters. The *City of Toronto Act*, for example, gives Toronto a wider authority to raise revenues, as well as other additional powers (City of Toronto, n.d.). Under Section 267 of the *Act*, Toronto has a general, but restricted, power to collect "direct" taxes. This is akin to the constitutional power of provincial governments to collect direct taxes (the federal government can collect both direct and indirect taxes).[5]

Examples of charters and special municipality statutes:

- *Vancouver Charter*
- *City of St. John's Act*
- *Charter of Ville de Montréal*
- *City of Toronto Act*
- *City of Winnipeg Charter Act*
- *Charlottetown Area Municipalities Act*
- *Charter Communities Ac*t (Northwest Territories)

The government of Alberta is considering city charters for Edmonton and Calgary to give these cities more taxation powers (Gerson, 2013).

In addition to limiting municipal revenue-raising powers, provinces also limit municipalities' borrowing ability. Canadian municipalities are not allowed to run deficits to cover operating costs, as federal and provincial governments commonly do. Borrowing to cover operating costs could allow municipalities to manage short-term cost increases and revenue shortages by balancing them over the longer term – just as businesses use lines of credit to manage fluctuating costs and revenues, freeing up cash for higher priorities.

Municipal borrowing to cover capital costs is also limited. Debt servicing (interest) costs are limited to a certain percentage, such as 15 per cent or 25 per cent, of total revenues.

All of these limitations notwithstanding, municipalities do have revenue-raising options available to them **(see Table B)**, and amendments to provincial legislation can provide additional options.

[5] Direct taxes are taxes that are levied on a person or corporation and generally cannot be shifted onto another party. Indirect taxes are taxes that are levied on a person or corporation and can be shifted onto another party (e.g. a sales tax paid by a vendor). In practice, provinces have very broad revenue-raising powers, including direct taxes and sales taxes, as well as user fees and other charges relevant to regulatory schemes. Toronto's power of direct taxation is limited by specific exceptions; for example, the city is not currently allowed to collect income tax or capital tax.

Table B

Municipal revenue sources by province/territory

	NL	PEI	NS	NB	QC	ON	MB	SK	AB	BC	NU	YT	NT
Property tax	■	■	■	■	■	■	■	■	■	■	■	■	■
Business tax	■				■		■		■				
Tax increment financing						■	■	■	■				
Area improvement tax		■	■		■	■	■	■	■	■	■	■	■
User fees	■	■	■	■	■	■	■	■	■	■	■	■	■
Poll tax	■												
Land transfer tax (LTT)			■		1	2	■						
Development charges	■	■	■			■	■	■	■	■	■	■	5
Hotel tax	6	■	7	■	8		■	■	■	■			
Amusement tax	9					10	■	■					
Advertisement tax						11	12			13			
Fuel tax					14	15	16			17			
Municipal finance authorities		18	■	■		■		■	■	■			
Income tax							19						
Sales tax							20	21					

1 In addition to general powers, Montreal has additional LTT powers.

2 In addition to general powers, Toronto has additional LTT powers.

3 The *Planning Act* gives municipalities the ability to do their own planning, but for most municipalities, municipal planning is run by the province.

4 Development cost charges are only in effect in the Halifax Regional Municipality.

5 The *Planning Act* (Section 38) states that developers must create their own infrastructure and pay for it themselves.

6 Applies to St. John's only.

7 Halifax Regional Municipality only.

8 Funds from this tax (an excise tax - $2 or $3 per night) are remitted to the tourism region, not to the municipality. Tourism regions are often larger than a single municipality.

9 Applies to St. John's only, and to date has not been implemented.

10 The City of Toronto has this power, but to date has not used it.

11 Only Toronto has this power, through the third party sign tax.

12 City of Winnipeg only.

13 The *Community Charter and Local Government Act* give municipalities the power to regulate but not tax signs – but with the power to regulate comes the power to charge fees.

14 The provincial government levies a $0.03/litre tax in the greater Montréal region on behalf of the Agence métropolitaine de transport through the *Fuel Tax Act*.

15 Municipalities receive share of provincial fuel taxes.

16 Municipalities receive share of provincial fuel taxes.

17 Greater Vancouver and Greater Victoria both levy a regional fuel tax to fund transit.

18 Municipalities can get provincial loans through the treasury board.

19 Municipalities receive a share of provincial income tax.

20 Municipalities receive a share of provincial sales tax.

21 Municipalities receive a share of provincial sales tax.

Municipal revenue sources and their progressivity

Municipal revenue sources can be categorized in a number of ways. The following categorization is similar to that used by Statistics Canada (Statistics Canada, CANSIM Table 385-0024), and is ordered by relative size of the revenue streams, averaged across Canada:

- property tax and related taxes (including business tax and land transfer tax)
- user fees (also known as revenues from sales of goods and services such as child care, water, and electricity)
- grants and transfers from other governments (these can be general-purpose or specific-purpose)
- consumption taxes (general and specific sales taxes/excise taxes)
- other taxes and revenues (licenses, permits, fines, penalties)

Municipalities across Canada vary in their use of these revenue sources. However, as shown above in Figure 3, property taxes are the major source of municipal revenues in Canada, followed by user fees and transfers from other governments.

The municipal revenue tools available to municipalities in each province and territory are outlined below, summarized in Table B, and discussed further in Appendix 3.[6]

Property taxes and related taxes

Property taxes are by far the largest source of municipal revenues, making up over 60 per cent of the own-source revenues of Canadian municipalities – revenues raised by municipalities themselves, as distinct from grants and revenues shared with municipalities by higher-order governments (Statistics Canada, CANSIM Table 385-0024).

The property tax rate (sometimes called the mill rate), multiplied by the assessed value of a given property, yields the property tax payable. Assessed values generally reflect market values, though assessments sometimes lag behind actual market value. The property tax rate is calculated by the municipality annually. The overall property tax revenue needed by the municipality, divided by the total assessed value of all properties, provides the tax rate. While renters don't pay a property tax, the property tax cost is generally passed on from the landlord to the renter as much as possible. About 69 per cent of Canadians own their homes, and 31 per cent rent (Statistics Canada, 2013).

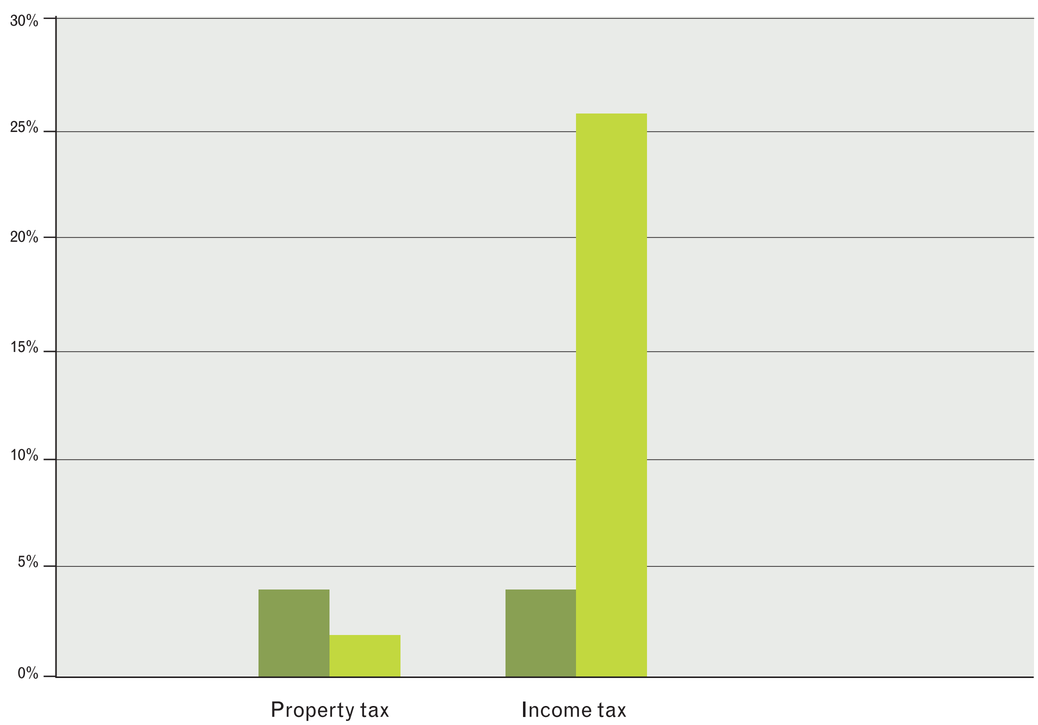
Property taxes are regressive because the proportion of income spent on property taxes is higher for people with relatively low incomes.

[6] Note: the discussion of powers here and elsewhere is for illustrative purposes only, and is not intended to be authoritative. Please consult the legislation in each province for the current and complete set of revenue sources available to municipalities.

"[L]ower-income families spend a higher proportion of their income on property tax than higher-income families. For example, in 1998, families with incomes below $20,000 paid an average of 10% of their income in property taxes, compared with under 2% for families with incomes of $100,000 or more. … Regressive property taxes cannot be attributed simply to seniors with relatively low incomes living in relatively expensive houses. In fact, municipalities where lower-income non-seniors have the heavier tax burden far exceed those where the reverse is true." (Palameta & Macredie, 2005, p. 14 and 18)

When compared to income taxes, property taxes are particularly regressive. With income taxes, the highest-income Canadians pay a higher proportion of their income – this is the goal of a progressive tax system. In contrast, with property taxes, the lowest-income Canadians pay a higher proportion of their income **(see Figure 8)**.

8 Percentage of income paid in tax, top and bottom income quintiles



Source: Federation of Canadian Municipalities (2008d)

Bottom 20 per cent income quintile

Top 20 per cent income quintile

The property tax is, to some extent, a tax on wealth. However it is a tax on gross rather than net wealth, as it doesn't exclude the amount owed through mortgages. Over half of Canadian homeowners (58.6 per cent) don't fully own their home, they have a mortgage, and the mortgages tend to be large, with over a quarter of households with mortgages exceeding CMHC's "affordability threshold," spending more than 30 per cent of their total income on shelter costs (Statistics Canada, 2013).

Since the property tax taxes the total value of the home, people with a relatively smaller portion of ownership (with a larger proportion of their home value mortgaged) end up paying more in taxes per dollar of value that they own. People with lower levels of wealth (and lower incomes) tend to have larger mortgages relative to their income and wealth levels. In addition, the property tax only covers housing and doesn't cover financial assets, which are predominantly held by the more affluent. And so, the property tax can be regressive with respect to actual wealth.

In some municipalities, particularly those in large census metropolitan areas, lower-income homeowners had a tax burden four or five times greater than their higher-income counterparts. (Palameta & Macredie, 2005, p. 18).

There are other problems with property taxes, apart from their being regressive. The argument that property taxes directly fund property-related services may not be as strong as sometimes claimed. Municipalities rely so heavily on property taxes that they fund a large proportion of the costs of a municipality, not just those costs that provide benefits to specific properties (Vander Ploeg, 2008b, p. 44). For instance, policing and fire services are unrelated to property value. In addition, residents pay through property taxes for roads, parks and libraries that are used by people living outside the municipality – who often pay lower taxes as a result. At the same time, property taxes do have positive attributes. They provide a stable source of revenue, and as they are connected to immobile land, they are not easily avoided.

While revenues from income and sales taxes increase automatically as sales and incomes grow, property tax mill rates (the tax rate per dollar of assessed value) have to be set every year. In many cases, when property values are rising, the actual property tax rates (as a percentage of the property value) are reduced. Yet the higher revenues are still characterized by tax opponents, as well as often in the mainstream media, as a tax increase.

"[T]he city may find itself having to constantly increase the rate simply to compensate for inflation…. In the media and the minds of the public, this is a tax increase." (Vander Ploeg, 2002, p. 3)

Residential and business taxation

Property tax rates for single-family homes are often lower than rates for multi-residential, commercial, or industrial properties with comparable market values. Some commentators simplify this as residential rates being lower than non-residential or "business" rates (this paper follows that convention for sake of convenience).

A review of eight Ontario municipalities found that "non-residential property taxes ranged from 28 to 51 per cent of total local property taxes but accounted for only 31 to 40 per cent of municipal expenditures" (Slack, 2012, p.77).

The gap between residential and non-residential rates exists in many Canadian municipalities, though this gap is shrinking (Kitchen & Tassonyi, 2012). Ontario introduced legislation in the late 1990s to ratchet down the differential and not allow it to be increased (Kitchen, 2013). According to Smart (2012) Ontario's reforms reduced commercial and industrial property taxes paid by approximately

$2 billion per year. In 2007, Vancouver moved to annually reduce the business share of overall property taxes. Non-residential property taxes now make up 48 per cent of Vancouver's overall property tax revenues, and are lower than the residential contribution (City of Vancouver Property Tax Policy Review Commission, 2014).

Despite concerns expressed over different residential and non-residential rates, and the political responsiveness to that concern, it is not clear that the rates should be the same. Businesses can deduct property taxes from income for the purposes of income taxation, whereas individual homeowners cannot (Slack, 2003). This suggests that residential rates may not be an appropriate gauge against which to compare non-residential rates.

Nor is it clear that "higher" necessarily means "too high." If non-residential rates are too high, they could have negative economic impacts, and could be a factor in businesses moving from cities to suburbs, where property taxes are lower (Slack, 2003). However, given that location is key for many businesses, property tax rates may not be high enough to have any noticeable impact, at least not in comparison with other costs. The evidence suggests that lower tax rates for businesses only have a small impact on business location, even when those differences are sustained for years (Smart, 2012). In Vancouver, although some continue to call for further reductions in the business share of property taxes, building permit data indicated that businesses were investing in Vancouver property and further reductions were not required (City of Vancouver Property Tax Policy Review Commission, 2014).

Poll tax a burden on low-income residents

Newfoundland and Labrador is the only province to allow municipalities to impose a poll tax. It is levied on people who live in an area but who do not pay property taxes. In 2012, 132 municipalities in the province levied a poll tax (British Columbia Ministry of Community, Sport and Cultural Development, 2012). Because people who do not own property generally have lower incomes, poll taxes are effectively a tax on the poor. Furthermore, property taxes are generally passed on from the landlord to the renter, making the poll tax an additional burden on the poor. The poll tax tends to be politically unpopular. Some municipalities, like the City of Corner Brook, are phasing the unpopular tax out, while Grand Falls-Windsor eliminated the tax from the 2014 budget because of its regressive effects (Hayward, 2013).

Taxes shifted off businesses and onto residents will tend to reduce the spending of those residents on goods and services – including those that the local businesses produce – as well as their willingness to live in the area and be part of the available workforce for those businesses. Of course, as with the business property taxes, the impact may not be noticeable.

In addition, since most business owners tend to have higher incomes, the effect of shifting property taxes onto residents may be to expand the impact of an already-regressive property tax. This would have a disproportionate impact on low-income earners – the people who can least afford to pay more taxes.

Finally, shifting taxes off businesses and onto individuals might result in some tax revenues leaking out of the municipality. Larger businesses are often owned by people living outside the municipality, and some of the foregone funds that could have been tax revenues from such businesses will be spent outside of the area.

Tax increment financing

Tax increment financing (TIF) is a mechanism intended to encourage private sector investment to finance improvements within a geographic area – often vacant land that has been contaminated by prior industrial or commercial use (brownfields), or areas with buildings that are abandoned or in severe disrepair. Public TIF funds are used to create new buildings or parks, revitalize physical infrastructure (sidewalks, lighting, streets, water mains, etc.), or remediate polluted land. TIF areas can vary in size from a few city blocks to an entire downtown core (Briffault, 2010).

TIFs work by using future increases in property tax revenues from higher property values to finance the cost of specific investments in a selected area. For the duration of the TIF (ranging from several years to a few decades), the tax revenues that flow into the municipality's general revenues are frozen at the pre-TIF level and, any additional property tax revenues (the increment) accrued during this period go towards financing those earlier public TIF investments (Kitchen, 2006; Joravsky, 2009).

TIFs are often seen as providing an economic stimulus to municipalities through the revival of blighted or brownfield land. They can thus have a progressive impact if they improve the lives of residents in depressed areas.

However, TIFs have been criticized on the grounds that the development may have happened anyway, and so the municipal investments are simply a subsidy to developers. TIFs can also end up raising property values in an area, forcing some residents out. Also, to the extent that TIFs reduce the incremental increase in revenues from the TIF area to fund general municipal services and programs (and thus require property tax rate increases elsewhere) they could have a regressive impact. However, this assumes that the revenues would increase in the absence of the TIF. Overall, the impact of TIFs on the progressivity of the municipal tax system is probably mixed, and minor.

Land transfer tax

A land transfer tax (LTT) is a tax payable on transfers of land, based on a percentage of the value of the property (the price paid, including mortgages or debt assumed). Most provinces have some form of land transfer tax or fee. But only municipalities in Nova Scotia, Quebec, Manitoba and Ontario (Toronto) separately collect revenues through LTTs, in some cases in addition to the provincial LTTs (Ratehub, n.d.). Because the LTT is a tax on property value and is structured similarly to property taxes, it could be as regressive as a property tax.

However, most LTTs in Canada are structured to be progressive in respect of the value of the property. Typically, they range from zero to 0.5 per cent for low value properties to two per cent for higher-value properties (Ratehub, n.d.). Also, because the LTT is collected on land transfers, it would tend to have a larger effect on those buying and selling properties more frequently, who tend to be higher-income people. Some jurisdictions (such as British Columbia and Ontario) refund all or part of the tax for first-time homebuyers, making the tax more progressive in impact. So the LTT's actual impact, generally, will be more progressive than that of the property tax.

User fees

User fees are charges levied for municipal goods or services, such as water and sewer services, public transit, parking, recreation or social services. They are the second-largest municipal own-source revenue stream, after the property tax. User fees can be structured as a fixed charge for unlimited access, as charges based on consumption, or a mix of the two.

In theory and in some instances, user fees may improve efficiency because the price associated with the service can help to restrain excessive demand. Goods and services provided without charge can, in some cases, be overused. In other cases, overuse of public services that have no user fees would be rare (for example very few people are fond of emergency waiting rooms, and will only go if necessary). With some user fees, citizens can see how the benefits they receive are reflected in the fees paid.

However, user fees are sometimes charged for services that have broad positive social and economic benefits, such as public transit, health care, education, recreation, child care, and libraries. Attempting to fully recover the financial costs of providing these types of public services from users is economically inefficient, and it also penalizes lower-income people. Furthermore, charging a price for a given service may not always be as effective at managing or reducing demand as other mechanisms, particularly for individuals and households.

Like sales taxes, user fees often have a regressive effect: they absorb a higher percentage of lower-income individuals' or households' income when compared with higher-income individuals or households. Some user fees are simply flat charges on a per-person or per-household basis. These are essentially the same as a poll tax, and are as politically unpopular. However, some user fees can be designed to be less regressive, as explained below on p. 45-46.

Road use pricing

Fees and charges for road use are designed to help cover part[7] of the costs of road construction and maintenance. They sometimes also generate revenue to subsidize public transit (British Columbia Ministry of Community, Sport and Cultural Development, 2013a), and reduce negative externalities and social costs (smog, greenhouse gases, congestion costs, road damage, road rage, lost time) involved with driving (Slack, 2006; Kitchen, 2006b). Congestion is a serious problem, costing Toronto alone an estimated $6 billion every year (Toronto Board of Trade, 2011). In 2012, drivers in Montreal and Vancouver each lost over 40 hours due to congestion (Inrix, 2013).

Road tolls can be flat fees, or may vary with distance traveled, location (by specific road or zone - cordon tolls), congestion (based on time of day), vehicle type, and number of passengers (i.e. high occupancy vehicles do not pay) (Kitchen, 2006b). At a municipal level, road tolls can make sense for large cities that experience high congestion rates. Each municipality could have the option of setting their own tax rate, though the European

[7] Note that road pricing, fuel taxes and other road user charges do not cover the full costs of roads in Canada; there is a net subsidy of $13.5 billion per year to road spending - supported by other taxes including income taxes and property taxes (Thompson, 2013).

experience "suggests that the mobility of the tax base will lead to similar tax rates across neighbouring jurisdictions" (Kitchen, 2006b, p.75 citing Evers et al., 2004).

Congestion tolls can reduce road use and generate revenue. For example, the City of London, England's congestion toll reduced road use by 15 per cent the year after it was implemented (Transport for London, 2004) and raised £222 million in 2012 (Transport for London, 2013). Similar results were also found in Oslo, Bergen, Stockholm, Santiago, and Singapore (Kitchen, 2006; Fletcher & McArthur, 2010). Road pricing can also increase overall traffic movement, reduce traffic volume, and reduce stop-and-go traffic – which in turn reduces emissions (Transport for London, 2013).

In Canada, road and bridge tolls are more common in Montreal and Vancouver. They have also been used to finance some public-private partnership projects, such as the Confederation Bridge between Prince Edward Island and New Brunswick, and Highway 407 near Toronto. However, these fees tend to be unpopular.

Other road user pricing systems include license and registration fees, as well as parking charges and taxes.

The effect of road user pricing is likely to be regressive, as many low-income automobile owners likely spend a higher portion of their income on road tolls. Because of their regressive impact, CUPE has not supported road tolls or other user fees that disproportionately negatively impact lower- and middle-income households (CUPE, 1999). Note that the lowest-income people do not own automobiles. The effect also depends on the location and who is using the road. If road users are predominantly lower-income people, tolls can be regressive. If road users are higher-income people, tolls can be progressive. To mitigate the regressive impact of tolls, the revenues could fund public transportation systems and affordable housing, and support other spending areas that benefit lower-income people.

Development charges

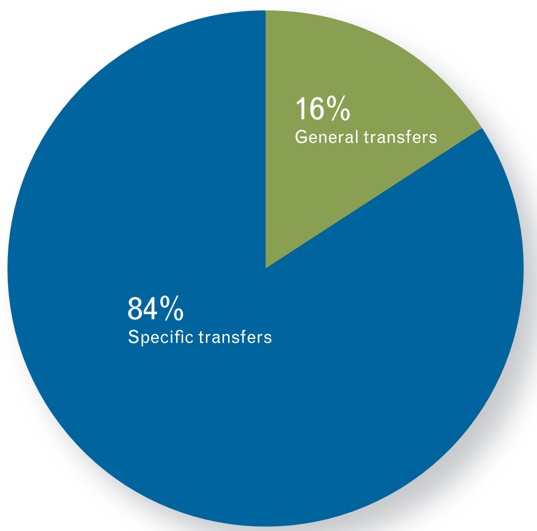
Development charges (DCs, also known as development cost charges and offsite levies) are fees collected when a permit is issued or development is approved for new residential, commercial, industrial, or institutional projects. These charges are intended to offset or reimburse the cost to municipalities of providing or improving infrastructure needed for those developments. DCs can be levied for various infrastructure costs such as sewer, water, and drainage systems; parks; or roads. These charges are meant to ensure that growth pays for growth, rather than having growth paid for by existing taxpayers – who may neither create the demand for, nor benefit from, the new development.

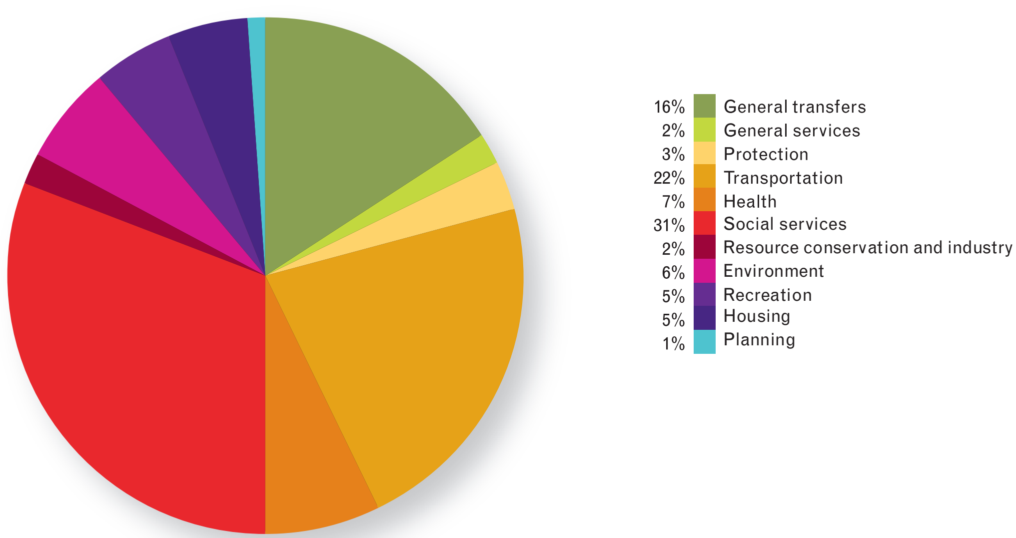
However, development charges do not always reflect the municipality's full cost, and as a result taxpayers subsidize the remaining costs. Thus there is room to increase DCs, as some municipalities are now doing (Thompson, 2013).

The progressivity of DCs could be mixed. As with any tax or user fee, some portion of development charges may be passed on from the developer to the buyer in the form of higher prices The relative size of the portions absorbed by the developer and the buyer will depend on the characteristics of the local property market (how responsive local supply and demand are to price changes). The portion paid by developers will generally be progressive (UBCM, 2013), as development firms are generally owned by higher-income people.

"In rising land markets the costs tend to be passed forward to buyers and in slow markets they tend to either be passed back to motivated sellers or result in land being taken off the market" (UBCM, 2013, p. 99)

9 Combined federal and provincial transfers to Canadian municipalities (2008)





Source: Statistics Canada Table 385-0024

8 2008 was the most recent year with these data available.

If the costs of development are not paid for by development charges, they will be paid for through the municipal revenue system, mainly through regressive property taxes, which are regressive and paid by people who may not benefit from the development – and indeed may be harmed by it (for example a development that increases traffic through their neighbourhood). This underscores the need to think broadly about the revenue system, and not just about particular revenue sources in isolation.

Grants, transfers, and revenue sharing

Higher orders of government have provided financial support to municipalities for many decades through grants and revenue sharing.

The terms grant and transfer are used interchangeably in much of the literature, and this report will follow that practice. Grants are funds that senior governments provide to municipalities. Unconditional grants are federal or provincial grants that can be used for any purpose chosen by the municipal government, and thus are the most useful for addressing locally-identified priorities. Conditional grants are federal or provincial grants that are designated for a specific purpose. These grants are much more common than unconditional grants **(see Figure 9)**, but don't necessarily address local priorities.[9]

Revenue sharing is a longer-term commitment of funding, and can take the form of a senior government sharing the revenue stream from a tax, such as Ontario's gas tax program (Ontario Ministry of Transportation, 2012), the federal Gas Tax Fund (Infrastructure Canada, n.d.), or the Building Manitoba Fund. Another option is sharing tax "points" or "room," for example, a reduction in provincial property tax (where those exist) and simultaneous equivalent increase in municipal property tax.

Grants and revenue sharing can serve a variety of purposes:

- to reduce the municipal fiscal imbalance and help municipalities (including lower-revenue municipalities) meet goals and responsibilities identified by senior levels of government providing the funding; and
- to help municipalities recover the costs of providing services to non-residents.

Grants and transfers as a share of total revenues have decreased over the last few decades (Kitchen, 2006b; Canada West Foundation, 2011b; Thompson & Bevan, 2010, p. 63), dropping dramatically after 1995 . They have slowly increased more recently, but have not yet recovered to pre-1996 levels (Statistics Canada, CANSIM Table 385-0024).

Grants and revenue sharing are subject to the criticism that they obscure accountability and impair democracy because the government spending money should obtain that money directly from their voters. More tangibly, receiving grants or shared revenue from higher orders of government can result in municipalities cutting own-source revenues.[10]

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9 Indeed, if a conditional grant also requires municipal matching contributions, it could reduce the amount of funds available for other municipal priorities.

10 Another criticism is that grants mostly fund infrastructure projects, and subsidies to infrastructure or facilities can reduce the incentive to municipalities to fully value and charge for services (leading to inflated demand and over-consumption), to achieve return on capital costs (Kitchen & Slack, 2003). Also, while roads and bridges can help an economy become more efficient, such grants don't necessarily support innovation and creativity that are essential to a municipality's competitiveness in the information era – members of the knowledge workforce are mobile and tend to look for "soft goods" like neighbourhood quality of life.

However, the economic and social impacts of a region extend beyond its borders, and the Canadian confederation has long conducted revenue sharing and equalization through different mechanisms.

Overall, the impact of grants and revenue sharing is relatively progressive. These revenue sources are funded largely by progressive income taxes (among other provincial and federal taxes), and displace regressive property taxes. On the spending side, grants and revenue sharing can level the playing field of spending capacity between have- and have-not municipalities, as well as offsetting the costs of providing services to those living outside of the municipality (Vander Ploeg, 2008b).

Consumption taxes

Consumption taxes come in two main categories: general sales taxes, and excise taxes (taxes that apply to particular items, also called selective sales taxes). There are several consumption tax options available to some municipalities.

American and European cities have access to sales taxes, and tend to rely less on property taxes than Canadian cities (Slack, 2003; Toronto Region Board of Trade [TRBT], 2013; UBCM, 2013). In the United States, most of the cities with access to sales taxes are restricted to selective sales taxes (Slack, 2003). However, in recent years, a few large cities have opted to enact a SPLOST (special purpose local option sales tax that is levied for a fixed term) and have generated significant revenues to fund specific capital projects (Canada West Foundation, 2011b).

Canadian municipalities currently do not have access to general sales taxes, though a penny tax (a one per cent local general sales tax piggybacked onto the GST) has been proposed (Canada West Foundation, 2011b; FCM, 2012b).

General sales taxes

General sales taxes are useful because they capture the economic activity of all consumers – both residents and visitors. However, because they are income elastic (revenues rise and fall with the economy), they are a somewhat unpredictable source of revenue from year to year, although generally more stable than income taxes.

Sales taxes can be costly to administer, both for government and for businesses. This cost can be reduced by combining the sales taxes of different orders of government.

Though there is horizontal equity in the application of consumption taxes (everyone pays the same per cent on a specific good or service), these taxes can have a disproportionate impact on lower-income people. The GST, for example, is regressive because lower-income consumers tend to spend a higher portion of their income on goods and services, and on the sales taxes that apply to them.

Several approaches are used to moderate this effect. Many necessary commodities are exempted or zero-rated, such as food, higher education, insurance policies, medical services, and children's clothing. Additionally, the current GST and HST tax systems offset regressivity to some degree at the lower end of the income stream by providing tax credits. However, studies of sales tax show the effective tax rate is still regressive (Davis et al., 2009). Certain municipal services, such as public transit, and water and sewer services, are also exempt from GST or HST. Federal and provincial governments provide municipalities and other public bodies including school boards, hospitals, and universities and colleges, with rebates for the GST or HST they pay. The value of this rebate is significant and will amount to an estimated $890 million in 2014/15 (Canada, 2013, p. 178). Some provinces, including Ontario, Nova Scotia and New

Brunswick, also provide municipalities with a partial rebate of the provincial sales and harmonized sales taxes they pay.

Excise taxes

Also known as selective sales taxes, excise taxes are levied on specific goods. Examples include:

- taxes on luxury items (hotel accommodations, restaurants, luxury vehicles);
- customs taxes and duties (imported goods); and
- "sin" taxes (tobacco, alcohol).

Most excise taxes are unit taxes, meaning they are levied per unit sold, and are not indexed to the price of the object they are levied on. In contrast, general sales taxes tend to be calculated as a percentage of price (known as *"ad valorem"*). For this reason, excise tax revenues don't rise with inflation like sales taxes. In order for revenues to grow, either consumption or tax rates must increase.

Excise taxes are sometimes described as the most regressive taxes because of their structure and the goods that they target (Joumard, et al., 2012). "Because sales taxes are levied at a flat rate, and because spending as a share of income falls as income rises, sales taxes inevitably take a larger share of income from low- and middle-income families than they take from the rich" (Davis, et al., 2009, p. 8). However, some excise taxes only apply to luxury items that higher-income people are likely to consume. In addition, excise taxes can be designed to be more progressive.

Hotel/Accommodation tax

The hotel tax is a tax on the use of hotels, motels, and other short-term accommodation. This tax is common at the municipal level throughout the United States and Europe (UBCM, 2013), and has been implemented in some Canadian municipalities (British Columbia Ministry of Community, Sport and Cultural Development, 2013). In Ontario for example, major hotels in a number of cities have a mutual agreement to collect a three per cent destination marketing fee (Fletcher & McArthur, 2010). The hotel tax collects revenues from non-residents, which makes it politically favourable, since tourists or commuters use a city's services (such as police and fire services, as well as road and water infrastructure) but don't otherwise pay for them. Some argue that the tax incurs an expense disproportionately high compared to the services that visitors receive from the municipality (Kitchen, 2000). In order to reduce administrative costs, they are generally applied as "an additional levy on existing provincial and federal sales taxes" (Kitchen, 2000, p. 20).

The hotel tax is likely to be somewhat more progressive than a general sales tax, since the amount paid will increase with income. This rests on the assumption that wealthier individuals will stay in hotels more often, and in more expensive rooms.

"Sin" taxes

Sin taxes are taxes added to certain goods or services such as alcohol, tobacco, or gaming. These taxes are used to discourage, and/or help pay for the negative consequences of, smoking, drinking and gambling. These taxes are generally at specific rates levied per unit of volume or count, instead of *ad valorem* taxes related to the price. Sin taxes are generally considered regressive (Kesselman & Cheung, 2004) but they aren't charged on essentials, and can be seen as socially progressive – possible reasons for their popularity among governments.

Amusement tax

Amusement taxes are levied on various forms of entertainment such as theatre admission (British Columbia Ministry of Community, Sport and Cultural Development, 2013a). For example, Winnipeg collects 10 per cent of admission fees to cinemas and venues of 50,000 seats or more (City of Winnipeg, 2006).

These taxes have small potential for revenue generation. They will most likely have a regressive, though overall minor, effect.

Advertisement tax

This tax applies to permanent signage including billboards, and is paid by the owner, not the advertiser (British Columbia Ministry of Community, Sport and Cultural Development, 2013a). In Toronto the *Third Party Sign Tax* was implemented in 2009, with the expectation of earning $10.4 million in revenue for the city annually (City of Toronto, 2010), some of which would fund arts and culture (Knelman, 2013). This tax is unlikely to have a significant progressive or regressive impact, though it would be somewhat progressive in that it would be passed on to corporations placing the advertisements, and generally corporations are owned by people with higher incomes.

Equipment tax

In Alberta, Saskatchewan, Manitoba, and Newfoundland and Labrador, equipment taxes can be levied against large machinery used for resource extraction such as oil and gas (British Columbia Ministry of Community, Sport and Cultural Development, 2013a). This tax can be challenging for municipalities to administer, as heavy machinery is often complex to track. An equipment tax is likely somewhat progressive in its impact on the resource extraction companies, which tend to be owned by wealthier people. Additionally, the oil and gas extraction industry is dominated by multinational firms. Taxation of that industry also allows for a portion of value to be retained locally instead of being sent to foreign shareholders.

Fuel tax

The fuel tax could be considered a user fee for roads, or a Pigouvian tax (see text box, p. 39). In Canada, the fuel tax is often a flat fee added to the price of fuel. This tax is added per unit to the fuel purchased, for example 10 cents per litre (British Columbia Ministry of Community, Sport and Cultural Development. 2013a). Fuel taxes could also take the form of an *ad valorem* tax, as a percentage of the base price (TRBT, 2013). An *ad valorem* fuel tax would allow revenues to grow with fuel prices.

In North America, local fuel taxes are currently implemented in Greater Vancouver, Greater Montreal, Victoria, New York City, and Chicago (Slack, 2003; Toronto Region Board of Trade, 2013). Montreal's fuel tax is three cents a litre and generates over $50 million annually in revenues (CBC News, 2010).

Fuel taxes provide substantial revenues, which are often earmarked for transportation infrastructure and services. Greater Vancouver levies a fuel tax of 17 cents a litre, which generates over $300 million annually to fund public transit (TransLink, 2012).

Administering a separate fuel tax is generally not considered an option for municipalities, especially small municipalities, because of the administrative costs. Instead, municipal fuel taxes are often added on to the existing provincial fuel tax, and municipalities receive a portion of the tax proportional to the amount collected within that municipality (Kitchen, 2000).

Most argue that a fuel tax is likely to have a neutral to regressive effect, taking up a higher portion of income among those making lower wages (UBCM, 2013). It is important to remember, however, that the lowest-income people don't own cars.

Though they may be regressive, fuel taxes are considered by many to be desirable because the amount an individual pays is directly related to how much driving that individual does. Fuel taxes would help reduce the human and economic costs of vehicle emissions, which can be very high (Thompson, 2013), and disproportionately affect lower-income people (Levin, 2012). Moreover, the substantial revenue fuel taxes can raise can be used to provide an overall progressive effect.

Externalities, market failures, and Pigouvian taxes

An assumption often made in introductory economics courses is that the purchase price in a market transaction includes all the costs of producing the good or service being sold. Unfortunately, the real world has few (if any) such ideal transactions, and there are often costs that neither the buyer nor the seller bear. The classic example is a factory producing a good and also releasing harmful emissions. The emissions are a real cost that isn't paid by the buyer or the seller. These costs are "externalized" from the market transaction; they are "externalities."

A Pigouvian tax (named after the economist Arthur Pigou who first formulated the concept of economic externalities) is a tax on a specific behaviour or commodity that generates negative externalities (Rosen et al., 2003). Such taxes are used to reduce the externality. The principal aim of a Pigouvian tax is to reduce negative side effects or consequences and thereby correct a market failure, rather than to generate net revenue. Of course, the revenues could be used for socially-progressive outcomes.

A carbon tax is a good example of a Pigouvian tax. A carbon tax is meant to internalize the external costs of carbon dioxide emissions. Carbon taxes, like fuel taxes, are not inherently progressive. However, Pigouvian tax revenue could subsidize other goods more beneficial to the public, and particularly lower-income people, such as public transit or affordable housing. Alternatively, or additionally, the revenues can be provided in the form of transfers to individuals. A flat transfer per person would have a progressive impact (Lee, 2012). A carbon tax or other Pigouvian tax, if designed correctly, could therefore reduce externalities as well as increase the progressivity of the overall fiscal system.

Fuel taxes key to transit expansion in Greater Toronto and Hamilton Area

The Transit Investment Strategy Advisory Panel report of December 2013 identified fuel taxes as a key funding tool for major transit plans in the Great Toronto and Hamilton Area (GTHA). Improving the transportation system is motivated by greenhouse gas emissions, smog, and the economic costs of traffic congestion (Metrolinx, 2008).

The panel stated that all would benefit from transit expansion, and therefore all should contribute to the cost. Among other recommendations, the report recommended a phased-in fuel tax. The funds raised in the GTHA from this tax would be dedicated to funding transit improvements in the GTHA. In other parts of Ontario, such as rural and northern municipalities, the funds would be directed more flexibly to infrastructure that is locally appropriate (Golden et al., 2013).

Other revenue and financing sources

Borrowing

Borrowing money is a suitable way for municipalities to cover capital costs, and sometimes operational costs. Borrowing funds for capital costs makes particular sense, because it helps align annual costs with the period of time when the investment provides services. Paying back the costs over the service life of the investment treats current and future users of the investment equally – they all pay for the service.

Borrowing to cover operational costs can be more problematic, which is one reason why municipalities face restrictions. In general, operational costs incurred over a period of time should be paid for over that period of time. Borrowing to cover operational costs would mean that future Canadians pay for current consumption, which is unfair. Note that unfairly borrowing against future generations is not unheard of. We often require future generations to pay for current consumption, for example, the climate change and other environmental debts we are building, as well as the infrastructure gap, estimated at $171.8 billion (FCM, 2012a) that resulted from decades of underinvestment in municipal infrastructure.

While operational spending is required over one period, it may be advantageous to raise the revenues over a different period. The federal and provincial governments frequently do this over the business cycle, and it makes sense: borrowing to sustain higher spending levels during recession, and paying down the debt later during the high part of the business cycle. Such stimulus investment is fair to future generations, as it is aimed at stimulating demand and thus promoting a stronger economy in current and future years.

While it is suitable for municipalities and other governments to borrow in certain circumstances, provincial governments restrict municipal borrowing by disallowing operational borrowing, and placing limits on capital borrowing. These restrictions are aimed at preventing municipalities from getting into a debt trap, where interest payments absorb so much revenue that municipalities can't afford to pay for needed programs and services. However, modern, large cities are often financially managed at least as well as some provinces, with long-range forecasting of revenue, expenditure and debt levels aimed at avoiding the debt trap. As such, provincial restrictions on municipal borrowing could probably be relaxed.

There are several methods municipalities can use to borrow funds.

Bonds

Bonds are primarily used to finance capital infrastructure projects. Municipalities issue bonds to lenders, and then pay them interest and the principal by the end of the lending period. Sometimes, payments are funded from the project itself. Both large and a growing number of medium-sized and even smaller municipalities in Canada are issuing bonds, borrowing directly through financial markets. Borrowing rates, particularly for public entities with good credit ratings, remain at historically low rates. This allows municipalities to borrow at less than two per cent over the short term and at close to four per cent or lower for longer-term bonds (Globe Investor, 2014).

However, an even more accessible option for municipalities to borrow at comparable rates is directly from provinces or through pooled financing facilities at the provincial level, such as Infrastructure Ontario, British Columbia's Municipal Financing Authority or municipal financing corporations in other provinces.

Government-facilitated financing

Government-facilitated financing can be more favourable than borrowing on the private market. There are differences in the models, but the principle remains the same: by pooling financing, municipalities can usually borrow at lower rates, with lower transactions costs and more favourable terms than if they borrow individually.

Municipal Finance Authorities

Municipal Finance Authorities (MFAs) are centralized provincial lending agencies with high credit ratings that are able to borrow funds at low interest rates, and in turn lend those funds at low rates to municipalities. In some cases municipal financing authorities have been able to borrow at rates as low as provincial governments. MFAs or similar bodies have been created in a number of provinces. They provide a model that benefits municipalities and could usefully be adopted by other provinces.

By saving money through MFAs, more money is available for services and programming with progressive impacts, avoiding higher property taxes, which are regressive.

Revolving funds

Municipalities can establish internal revolving funds, with municipal departments borrowing from those funds to finance capital investments, and paying back the capital to the funds over a period of time. For example, Edmonton's Energy Management Revolving Fund finances energy efficiency retrofit projects (City of Edmonton, n.d.). Revolving funds can be filled by revenue streams earmarked for the purpose, and can get financial backing from provincial MFAs. The

Federation of Canadian Municipalities also operates a very successful revolving fund, the Green Municipal Fund.

Infrastructure banks

Infrastructure banks have been used in the United States, and there have been proposals to establish banks in Canada. Infrastructure banks arose out of revolving funds and bond banks, which bundle loans to obtain lower issuance costs and interest rates (Crockatt & Prentice, 1999; Puentes & Thompson, 2012). They provide low-interest loans and credit enhancements to allow projects seeking financing to move forward. Interest in infrastructure banks was partly driven by public sector accounting rules, which had required governments to expense all capital spending.

Public-private partnerships (P3s)

Public-private partnerships (P3s) are often promoted as a way to obtain private sector investment in public assets and services. However, that money needs to be paid back, and so P3s are really a transfer of costs from taxpayers now to (a) taxpayers at a later date, or (b) a different group of people (users of the service who pay fees, instead of taxpayers), or both.

P3s are also costly. Private investment requires a profit for shareholders, which represents value extracted from the service or from those paying for it. Pay premiums for executives and managers are considerably higher and transactions costs – fees paid to financiers, lawyers and consultants – are also much higher with P3s. Higher private borrowing costs also considerably increase the real cost of P3s (Loxley, 2012). While the details of the costs and liabilities of public-private partnerships are generally not disclosed, when federal or provincial auditors have examined P3s, they have generally found that the P3s cost considerably more than traditional public procurement (Loxley, 2012, p. 29). There is also increasing recognition of the growing liabilities P3s are creating for governments, and that these need to be reflected in public accounts.

P3 advocates claim P3s reduce public sector risk and incentivize creativity and innovation (TRBT, 2013, Canada Mortgage and Housing Corporation, 1999). However, studies have found risk transfer to be significantly overestimated (Loxley, 2013; Siemiatycki & Farooqi, 2012). In general, any real risks could be covered with lower-cost insurance without using more expensive P3s. Unfortunately, the value for money assessments used to justify P3s rarely disclose the details behind their numbers. They also tend to ignore the real risks and problems associated with P3s, including bankruptcy,[11] lack of direct accountability and transparency, contractual rigidities, lack of flexibility, problems with quality of service, public access, and costs.

Ultimately the final risk remains with the public – the public sector body will always be ultimately responsible for providing the relevant service if the private sector operator walks away.

Some advocates claim that P3s and privatization reduce labour costs. These reductions would be achieved by firing municipal workers or cutting their salaries. This in turn reduces the buying power of individuals who tend to spend on local goods and services. The ripple effects would reduce economic activity and employment across the local economy, including in the private sector. Those cost "savings" effectively amount to an offloading of costs onto families, communities, and the economy overall, while wealthy owners of the larger, often multinational, P3 firms extract profits. In the end, some of the labour cost reductions are actually a redistribution of costs that also undermines progressivity.

[11] Witness recent cases in long term care (Gibson & Clements, 2012).

Gaming revenues

The debate about the use of gaming revenues for municipal finance is a heated one in Canada. Using casinos, slot machines and other gaming opportunities to raise revenues is tempting for municipalities given that revenues are high and financial costs (such as increased regulation) are low (Williams et al., 2011). The Canadian experience with gaming at the municipal level is mixed, with some municipalities claiming it is a success (such as Brantford and Windsor) and other refusing to allow it at all (Toronto and Surrey have voted against casinos) (Mendelson, 2013; Hill, 2013; Church & Dhillon 2013; Jang, 2012).

Some advocates argue municipalities also benefit from economic and jobs stimulus with casinos. Critics note that, though gaming revenues can offer a quick fix for revenue problems, the economic case for the municipality may be overstated, as the disposable income spent on gambling is often at the expense of other local businesses. This can be mitigated to some extent by building a resort complex aimed at out-of-town gaming clients (Philander, 2013).

The progressivity of such revenues hinges on both the demographics of gaming users (those from whom gaming revenues are extracted) and the distribution of the social costs of gambling. Research confirms that while people with higher incomes spend more on gambling than lower-income people, lower-income people consistently spend proportionally more of their income on gambling than middle- and high-income groups (Williams et al., 2011; Philander, 2013). On the social impacts side, a meta analysis of the socioeconomic impacts of gambling concludes that the most consistent social impacts across all forms of gambling tend to be increased problem gambling, increased crime (to a small extent), and increased socio-economic inequality (to a small extent). The net regressivity of gambling revenues could be offset by increased social and infrastructure spending, if it was directed toward lower-income citizens (Philander, 2013).

Sale of assets

It could be tempting for municipalities facing cash flow challenges to sell off assets (potentially privatizing services provided by those assets, and allowing costs to fall on users). Of course, selling an asset is a fairly desperate measure, as it can only be done once, and any potential future income from a revenue-producing asset is lost – boosting reliance on other regressive sources of revenue, such as property taxes. Selling an asset to fund operations is akin to borrowing to fund operations. In both cases, the municipality's balance sheet (assets minus liabilities) is degraded in order to fund operations.

Royalties/charges on pits, quarries & aggregate

Royalties are not a form of taxation, but are a charge on the resource being extracted. There are different ways royalties can be structured, for instance based on revenues or profits.

There are some risks to relying on these revenues. They are subject to fluctuations of commodity prices, which can be based on boom and bust cycles. And those based on the sale of a finite, non-renewable resource eventually dwindle as the resource becomes depleted.

Resource charges are not inherently progressive or regressive, it depends how they are set. They can be regressive where those rates are artificially low, allowing the value of a public good to boost private profit levels at a cost to the public balance sheet. The windfall profit would be received by business owners, who in this sector tend to be wealthy, while if those revenues had been captured by the government, they would have benefited the broader public, including lower-income people.

Four revenue options and their relative progressivity

This section examines four potential revenue options and their relative progressivity. These four were chosen primarily because of their importance as existing municipal revenues and in discussions of new revenue options, and their potential for making the overall revenue system more or less progressive.

Income taxes

In the developed world, most municipalities have access to income tax revenues. Within the OECD, close to 60 per cent of countries allow municipalities to either levy their own income taxes or access senior government income tax revenues (Kitchen, 2000; OECD, 2010). In Canada, direct municipal income taxation is not currently permitted under current provincial legislation.

Another major benefit of income tax revenues is that they automatically grow with growing incomes and the economy. The downside to this is that income tax revenues are not as predictable from year to year (Slack, 2003).

Income taxes are generally progressive – marginal tax rates increase with income, while low- and no-income families are exempted from the income tax. Income taxes are also an important instrument for reducing income inequality in Canada. Post-tax income equality, as measured by the Gini coefficient is significantly improved compared to pre-tax income distribution in Canada (Sharpe & Capeluck, 2012).

Municipalities could collect income taxes through two different routes. They could receive a dedicated share of the personal or corporate income tax, or they could levy their own independent income tax. While the latter option would enable direct control over the tax schedule, and arguably greater political accountability, the administrative costs would be high. It could also facilitate policy competition between municipalities, driving taxes down. To prevent this, and maximize efficiency, income taxation as a municipal policy tool should be administered at a higher level of government.

According to the Union of British Columbia Municipalities, "[t]he prevailing view of tax professionals is that a local share of income taxation could only be provided through a tax or revenue sharing arrangement with the applicable province" (UBCM, 2013, p. 49).

Manitoba shares its income tax with municipalities based on population proportionality. The province provides municipalities with the greater of either one percentage point of the provincial sales tax, or a combination of a 4.15 per cent share of the provincial income tax and a portion of provincial fuel taxes, two cents per litre of provincial gasoline tax, and one cent per litre of provincial diesel tax. A share of the income tax for municipalities in Newfoundland and Labrador could "increase average municipal fiscal capacity by 20.7%" (Locke, 2011, p. ii).

Income taxes with a constant rate would be the easiest to administer (a civic surcharge added to the federal/provincial taxes due) and would be as progressive as the underlying rate. A true multi-rate system, as the federal government and most provinces have, would be more progressive.[12] New York City applies a progressive income tax on its residents, with higher rates for higher incomes. (New York State Department of Taxation and Finance, n.d.).

[12] For further discussion of income tax considerations for local and provincial governments, see UBCM, 2013.

A local share of sales tax

Local sales taxes could be very useful to municipalities, as they can raise considerable amounts of revenue. A local sales tax could also target non-resident users of municipal services. "The imposition of a retail sales tax would allow the local jurisdiction to use the tax system directly in order to recover some of the extra costs of providing local services (roads, streets, public transit, police protection, and so on) that are required in order to accommodate nonresidents (visitors and commuters)" (Kitchen, 2000, p. 20).

As with an income tax, there are two ways for municipalities to levy a sales tax. One option is for the municipality to create an independent tax infrastructure and maintain it, including securely tracking taxpayer data. This is a relatively costly option to create and administer.

The other option is a municipal sales tax that is added onto an existing sales tax, with revenues collected by a more senior government and remitted to the municipality. This option has been proposed, for example in the form of a new one per cent local sales tax noted earlier, nicknamed 'the penny tax,' to be added onto the federal GST (Canada West Foundation, 2011b; FCM, 2012b). A one per cent share of the provincial HST in Newfoundland and Labrador could "increase average municipal fiscal capacity by 15.7%" (Locke, 2011, p. ii).

In the United States, direct sales taxation by the municipality is sometimes implemented in the form of a "special purpose local option sales tax" (SPLOST). This type of tax has become prominent in some American cities, helping them raise revenues for specific infrastructure projects. The SPLOST takes the form of a general sales tax, targeting a broad base of goods, but differs substantially from general sales taxes in two ways. First, the SPLOST is often earmarked for specific spending such as roads, buildings, and large or expensive equipment such as police cars or fire trucks. (Association County Commissioners of Georgia, 2011). Second, it is usually temporary, not normally lasting more than two election cycles (Canada West Foundation, 2011b). Such restrictions in scope and timing can help sell the tax when it is introduced, but essentially defer political challenges to later dates when other infrastructure or services require financing, or when the tax expires. In Atlanta, the SPLOST has saved the city an estimated $1 billion since 1985, by reducing the amount of interest paid on money that otherwise would have been borrowed (Nash, 2013).

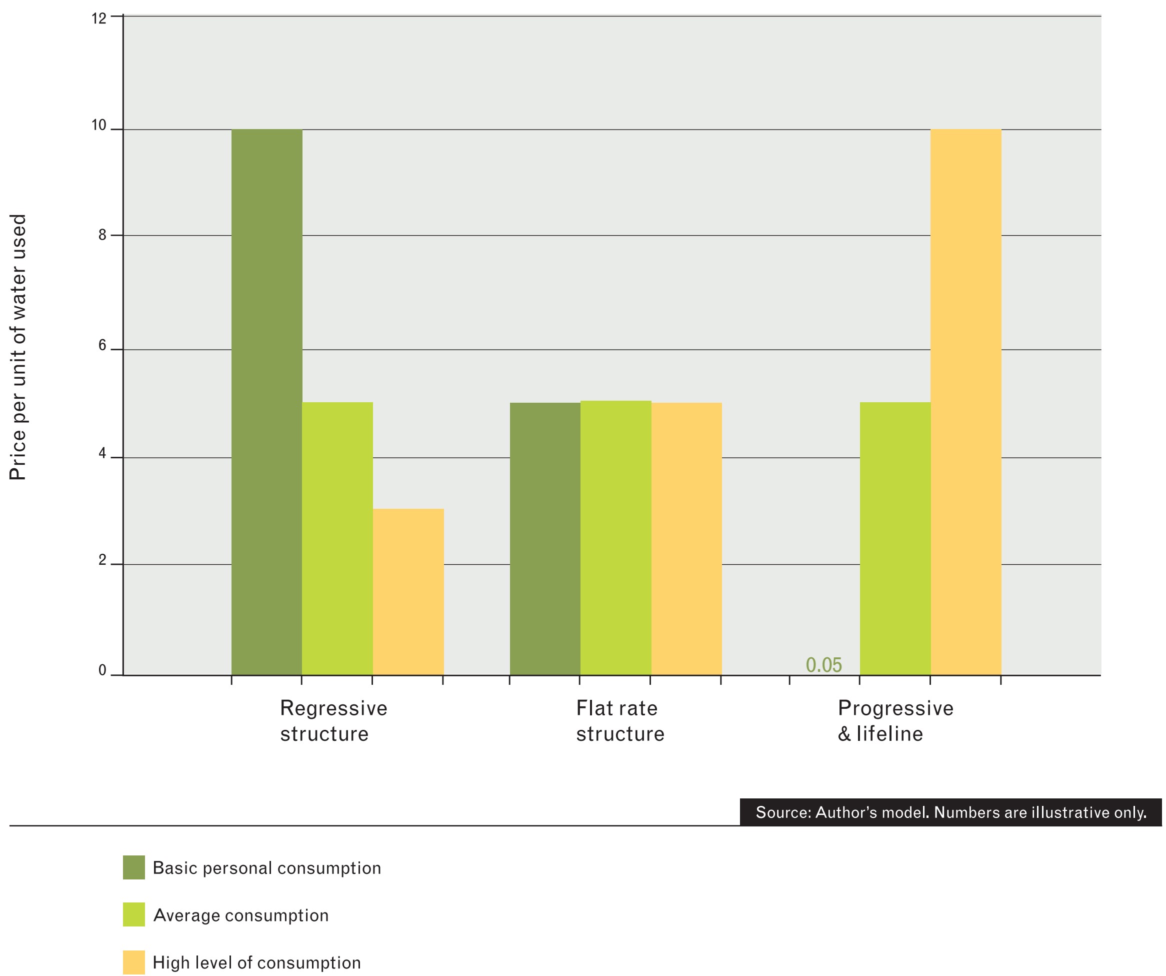
While sales taxes have a regressive to neutral effect on the taxpayer (Davis et al., 2009), they can generate billions of dollars for municipalities, and the projects and services funded by those designated taxes can have progressive impacts. Mackenzie and Shillington (2009) estimate that 80 per cent of Canadians would have been better off if, instead of the recent one per cent federal GST cut, the funds gone to local governments so they could better fund public services. The benefits of public services outweigh any potential financial benefit of tax cuts for the large majority of Canadians.

User fees that are more progressive

User fees can be designed to be more progressive and can be used to try and reduce or control consumption.

Flat user fees that are levied on a per-person or per-household basis are regressive. An example would be a waste removal charge or water supply charge that is a fixed sum per household. In some instances, water charges are even reduced for higher levels of consumption. Some regressive fees can be changed by adopting a service fee schedule that reflects consumption levels, thereby reducing over-consumption and being less regressive **(see Figure 10)**.

10 Illustration of regressive, flat and lifeline water rates



Other things being equal, people with higher incomes tend to consume more of many goods and services. For example, a lower-income household might only use water for cooking and sanitation, while a high-income household may also water a large property, fill a swimming pool, and wash cars. The higher level of consumption can be charged at a higher rate (termed inclined block billing, or positive block billing). This is an increasingly popular rate structure among water utilities (Thompson & Bevan, 2010). Zero-level fees at the lower end of consumption levels are often termed a "lifeline rate" (see Figure 10). In the case of water, a lifeline rate could be said to reflect a human right to a certain basic amount of water consumption.[13]

[13] The importance of water as a human right was underscored by the United Nations Special Rapporteur, when the government of Canada proposed weakening that right in negotiations. See: United Nations, Office of the High Commissioner for Human Rights, 2012.

Solid waste disposal provides another example of this rate structure. Municipalities can accept one trash bag per week (again reflecting modest personal consumption), while additional bags could be charged for on a per-bag basis.

Full cost recovery is not an economically efficient goal for the provision of tap water, for wastewater services or other goods and services associated with positive externalities (positive social, environmental or economic benefits). Generally, a subsidy is appropriate in the case of positive externalities, and charges and taxes are appropriate in the case of negative externalities. Examples of areas where there are significant positive externalities include public education, preventive health care, and improvements to the environment. Examples of negative externalities include pollution and depletion of common resources. Water is an important public good, in that it is essential for sanitation and health. Provision of clean water and sanitation services were important factors in controlling outbreaks of waterborne disease. Using high water rates or a rate structure that is regressive could cause hardship for lower-income people and increase health risks to them and to others.

Other techniques can also be used to reduce the regressivity of various user fee systems, including rebates, vouchers, and credits for lower-income people. For example, the city of Calgary's User Fees and Subsidies Policy states that user fees "should be accompanied by a documented strategy for subsidies to qualified individuals" (City of Calgary, 2012b, p. 7).

"The setting of fees charged to Calgarians for personal or family use of The City's programs, services, facilities and public spaces will reflect the relationship of cost to Calgarians' financial capabilities and the value attached to the use of the services and may require setting of differential fees to be based on income, service location, community, duration of service and the type of service, including special measures to persons without adequate income, to ensure affordability for all Calgarians." (City of Calgary, Fair Calgary Policy, 2012a, p. 6-7)

A consumption-based fee schedule with a lifeline rate at the lower end, and possibly some other subsidies for lower-income people would not be progressive in the same manner as a progressive income tax. However, it can be substantially less regressive than a flat rate fee, and so can make a municipality's overall revenue system more progressive.[14]

Progressive property tax

Property taxes can be made more progressive in various ways: restructuring rates by dwelling type, restructuring rates to make them rise with property value, increasing the proportion of taxes paid by businesses, and giving a personal income tax credit.

Restructuring rates by dwelling type

Other things being equal, higher-income people tend to live in single-family homes, while low-income people tend to live in multi-family dwellings. Currently, many municipalities levy higher property tax rates on multi-family dwellings than single-family homes. A common justification for the differing rates is that apartment buildings are usually owned by a business, meaning the property tax can be written off as a business expense. However, under such a system, single-family dwellings that are rented for business income will not pay that higher tax. Furthermore, it is likely that the business entity will pass on much or even all of the cost to tenants in higher rent. By reducing

[14] In theory, the federal or provincial government could offset distributional impacts of regressive user fees by making income tax structures and personal transfers more progressive. However, the reality is that making the tax-and-transfer system more equitable has not been a priority for either level of government in recent decades, and thus municipal governments need to design their own revenue and spending systems to protect lower-income people from negative impacts.

multi-family tax rates, as some boroughs in Montreal have done, the property tax system could be made somewhat more progressive.

Restructuring rates to make them rise with property value

Property tax rates in Canadian municipalities currently don't vary by property value. This means a $200,000 house and a $20 million house are taxed at the same percentage rate. This could be termed a proportional or flat tax with respect to property value. It is possible to allow for property tax rates that are scaled to value, so that the rate is lower for lower-valued properties – in much the same way that the income tax rates are lower for lower levels of income. Of course, property value is not the same as income, but other things being equal, people with higher incomes tend to own properties of higher value. Singapore has enacted a progressive property tax with marginal tax brackets that function much like our income tax. The marginal property tax rate increases with property value. This has made property taxes affordable for low-income earners, while only increasing the property taxes that are paid by those who are most able to pay (Singapore Government, 2013).

Increasing the proportion of taxes paid by businesses

Businesses owners generally have higher incomes than those who do not own businesses. Municipal property tax rates are often higher for commercial and industrial properties than for residential properties. In recent years, there has been a trend toward narrowing these differentials. Restoring and enhancing the differential would help to make the property tax system more progressive.

The land transfer tax, being a tax on the value of property transferred, can be seen as a form of property tax. It is more progressive than the property tax, as it is often structured to have a higher rate for higher-value properties, and it would effectively apply more to those buying and selling frequently (often businesses owned by wealthier people). Boosting the land transfer tax, rather than the property tax, would make overall property taxation more progressive.

Providing personal income tax credits

This option involves governments providing tax credits through income taxes or other mechanisms to reimburse residents for a share of the property taxes they pay. A flat income tax credit would be progressive – it would provide proportionally more money to a low-income homeowner than to a high-income homeowner, and even more progressive is a tax credit that that phases out at higher incomes. For example, Ontario and Manitoba both provide income-based tax credits as a reimbursement for property taxes. These programs are targeted specifically to seniors and people with lower incomes (Ontario Ministry of Finance, 2014, Manitoba Finance, 2014).

Assessing the fairness of municipal revenue options

Municipalities face challenges in balancing their budgets while providing the services that their residents require. They also need to ensure their overall revenue system is progressive, not only to ensure people contribute according to their ability, but also in order to be accepted by voters - who overwhelmingly support progressive taxation.

In analyzing available revenue options and the overall revenue system, the foregoing discussion of revenue sources and their impacts helps illustrate the range of factors that could come into play. Emerging from the above discussion, a number of principles, or a "fairness screen" could inform analysis of potential revenue options:

1. Revenue sources with progressive impacts (such as a share of income taxes) should be used to displace revenue sources with regressive impacts (such as property taxes).
2. To the extent possible, municipally controlled revenue sources should use rates tied progressively to income, wealth, consumption of luxuries, or other similar factors.
3. Where possible, basic consumption levels of essential goods and services should be exempt from user fees.
4. Where possible, revenues should come from taxing behaviours or goods that have harmful environmental or social impacts, rather than those with broad positive environmental, social or economic benefits
5. Income-based tax exemptions, rebates and credits should be used to reduce the regressive impact of some taxes or fees, and enhance progressivity.
6. In addition to analyzing new revenue options, existing revenue sources should be analyzed for their relative progressive or regressive impact.
7. Spending associated with a new revenue source (whether earmarked or simply established at the same time) should also be analyzed for its relative progressive impact. A somewhat regressive or neutral revenue instrument could be part of a larger policy initiative that includes a progressive spending element.

Conclusions

Municipal public services are both vitally important and a great bargain for Canadians. Many of these services could not be purchased on the private market, and overall citizens save enormous sums by collaborating with their fellow citizens to "buy in bulk." For the vast majority of Canadians, "public services are, to put it bluntly, the best deal they are ever going to get" (Mackenzie & Shillington, 2009, p. 3). Public services also create a greater level of fairness, as they provide more benefits proportionately to lower-income citizens. Not surprisingly, Canadians overwhelmingly support governments providing these services.

Canadians also strongly support taxation to pay for municipal services, particularly progressive taxation. Municipalities do require a wider range of revenue options to draw upon. However, they also have a number of existing sources. In assembling the revenue options that will support future spending, municipal policymakers will need to pay attention to the regressive or progressive impacts of both the revenue sources and the spending.

To make the overall revenue system more progressive, existing revenues can be made more progressive (or less regressive), and new and more progressive revenue streams can be added to the system. This paper has reviewed many revenue sources, but the most important in municipal revenues and discussions of municipal revenue options are property taxes, user fees, income taxes, and sales taxes.

Municipalities urgently need a wider range of revenue options. In assembling the revenue options that will enable future expenditures, municipal policymakers will need to pay attention to the fairness and equity impacts of both the revenue sources they choose, and how that revenue is spent. A set of principles or a fairness screen could help guide discussion of revenue options toward a more successful and fair system overall. We hope that this paper will help touch off a more sustained examination of these issues at the municipal level.

Appendix 1

Canadian values: support of government and progressive taxation

Canadians value government programs and services. Environics polling found that a strong majority (68 per cent) agree that "governments are essential to finding solutions to the important problems facing the country" (Adams, 2013).

In particular, Canadians value municipal programs and services. Calgary mayor Naheed Nenshi in his re-election acceptance speech stated: "We are investing in the things that make life worth living: Libraries, recreation centres, parks and public spaces, and so that all Calgarians can participate in this life" (Tsui, 2013). Municipalities play an important role in providing infrastructure and services that support a good quality of life.

Canadians recognize that taxes are required in order to pay for the services they want. Environics polling found that "three-quarters of Canadians believe taxes are generally a positive thing, as opposed to one in five (19 per cent) who think taxes are mostly a bad thing" (Adams, 2013).

Canadians also support having a fair tax system – one that is progressive and based on ability to pay. The foundational royal commission on Canadian taxes, The Carter Commission, was clear about these Canadian values.

More recently, after decades of growing income inequality in Canada, the topic has become a front-burner media issue (see *The Globe and Mail*'s November 2013 *Wealth Paradox* series). Canadians understand the harmful effects of inequality: 79 per cent of Canadians believe unchecked income inequality will have a negative impact on our standard of living (Broadbent Institute, 2012). These responses were consistent among a broad range of income and age groups.

There is growing mainstream recognition that the tax system can help reduce inequality (see for example, Tedds, 2013). Environics polling found that "a large majority (82 per cent) agree either strongly (50 per cent) or somewhat (32 per cent) that 'governments in Canada should actively find ways to reduce the gap between wealthy people and those less fortunate.'" (Adams, 2013). A majority of Canadians are willing to pay higher taxes to protect our social programs (Broadbent Institute, 2012).

Moreover, Canadians support progressive taxation. The large majority agree that people with high incomes should pay higher tax rates. Environics polling showed that 83 per cent are in favour of increasing income taxes on the highest income earners (Broadbent Institute, 2012). An Ipsos-Reid poll found consistent results: 88 per cent of Canadians feel "the rich should pay more taxes," with only 12 per cent disagreeing. This support was strong across the country, with the lowest level of support in any province being 82 per cent, in Alberta. Support was also strong across all income levels, with the lowest level of support being 72 per cent, among those with household incomes over $100,000. The average Canadian defined incomes of $195,000 per year as being rich. Canadians overwhelmingly support a special tax on the very richest, with 89 per cent in favour of an additional tax on family income in excess of $1 million per year (Ipsos Reid, 2013).

This strong public support for progressive taxation is not lost on municipal officials. A 2010 study showed that 52.8 per cent of British Columbia mayors, councillors, and municipal staff agreed (or strongly agreed) that they should structure their tax policy "through the lens of tax fairness for lower-income people" (Fletcher & McArthur, 2010, p. 11). Only 32.9 per cent disagreed, with 14.3 per cent "undecided.

If it means maintaining or improving municipal services, Canadians are happy to pay their taxes. The 30-year old anti-tax, anti-government campaign that was so influential in shaping the discourse of media and political elites (of all parties) appears not to have been successful in persuading the majority of Canadians. Groups such as Canadians for Tax Fairness, Doctors for Fair Taxation and Lawyers for Fair Taxation are actively advocating for increased taxes. Their message to government is "Tax us. Canada is worth it!" (Doctors for Fair Taxation, 2013; Lawyers for Fair Taxation 2013). Long-standing values of Canadians – fairness, sharing and caring – are intact, despite the decades-long anti-tax campaign.

The majority of municipal residents support municipal taxes and services, while only a small minority would like to see services and taxes cut. Polling of cities across Canada shows that supporters of municipal taxes out-number those who would like to see tax cuts by large margins **(see Table C, below)**.

Table C

National support for municipal taxation (2012)

Preference	Per cent
Increase taxes to enhance or expand services	22
Increase taxes to maintain services at current level	32
Cut services to maintain current tax level	22
Cut services to reduce taxes	11

Source: Ipsos Reid, 2012

The anti-tax movement

The mainstream media frequently carries the anti-tax message, but it is not responsible for creating that message. Anti-tax sentiment has been around for a long time, but the last few decades saw the development of an aggressive anti-tax movement.[15]

This conservative movement has prioritized the demonization of taxation and government, and has succeeded in distorting the mainstream conversation around taxation to the point where political parties across the spectrum have embraced tax cutting and are afraid to propose tax increases (Himelfarb, 2013b). Fortunately, to date this movement has failed to convince Canadians, particularly at the municipal level.

"The movement for tax cuts in Canada has been the political equivalent of a bait-and-switch sales campaign. The populist rhetoric about the tax burden on the ordinary family has given way to actual tax policy changes that have overwhelmingly benefited only a very small proportion of the population — Canada's richest taxpayers."
(Mackenzie & Shillington, 2009, p. 20)

The tax changes made since the 1990s have not benefitted the majority of Canadians. Had the one per cent of the GST that was cut by the federal government in 2007 instead been diverted to municipal governments to fund services, 80 per cent of Canadians would be better off, according to the analysis of Mackenzie & Shillington (2009, p. 21). Had provincial governments invested in health care and education rather than cutting income taxes in the late 1990s and early 2000s, 75 per cent of Canadians would be better off (Mackenzie & Shillington, 2009, p. 22).

Progressive redistribution after taxation also can create an overall positive social and economic effect even if the tax base is relatively regressive. Investing in social services such as education and health has a redistributive effect. Countries that spend more on social transfers (such as Denmark and Sweden) have relatively low income inequality (Prasad, 2008).

This illustrates the importance of considering not only the relative progressivity of a particular revenue source, but also the relative progressivity of the revenues it might displace and of the spending that it might enable.

[15] For a general discussion of this movement, see Gibson, 2013; Lapham, 2004; Himelfarb, 2013a.

Appendix 2
Progressive revenues

Taxes can be progressive, proportional (neutral), or regressive in their impact on income distribution. A progressive tax rate rises in relation to income, so that people with higher income levels pay higher tax rates, reducing after-tax income inequality.

The income tax system in Canada is an example of a progressive tax. It is linked directly to income levels, while other taxes can only approximate that linkage through proxies (consumption levels, luxury goods, wealth, etc). High income earners pay a larger proportion of their income in taxes than do low income earners. For illustration: in 2013, the federal tax rate was 15 per cent on the first $43,561 of taxable income versus 29 per cent on taxable income over $135,054 (Canada Revenue Agency, 2013).

The overall progressivity of the federal and provincial/territorial tax system has been significantly eroded in recent decades. The highest tax bracket on average across the provinces plummeted from 80 per cent in 1948, on income over $250,000, to 42.92 per cent in 2009, on income over $126,264 (Canadian Tax Foundation, 2009).

However, income taxes rates at both the federal and provincial/territorial levels in Canada remain progressive with the sole exception of Alberta. Alberta introduced a flat tax more than a decade ago. Alberta's flat tax, at 10 per cent of income, is not a popular option with the public. Sixty per cent of Albertans agree that "people with higher incomes should pay a greater share of the taxes than they do now," with only 21 per cent disagreeing (University of Alberta Population Research Laboratory, 2013, as cited in Bower, Harrison & Flanagan, 2013, p. 16). This is consistent with overall Canadian support for progressive taxation; 60 per cent of Canadians surveyed by Ipsos Reid oppose flat taxation (Ipsos Reid, 2013). Perhaps for this reason, no other provinces have introduced flat taxes.

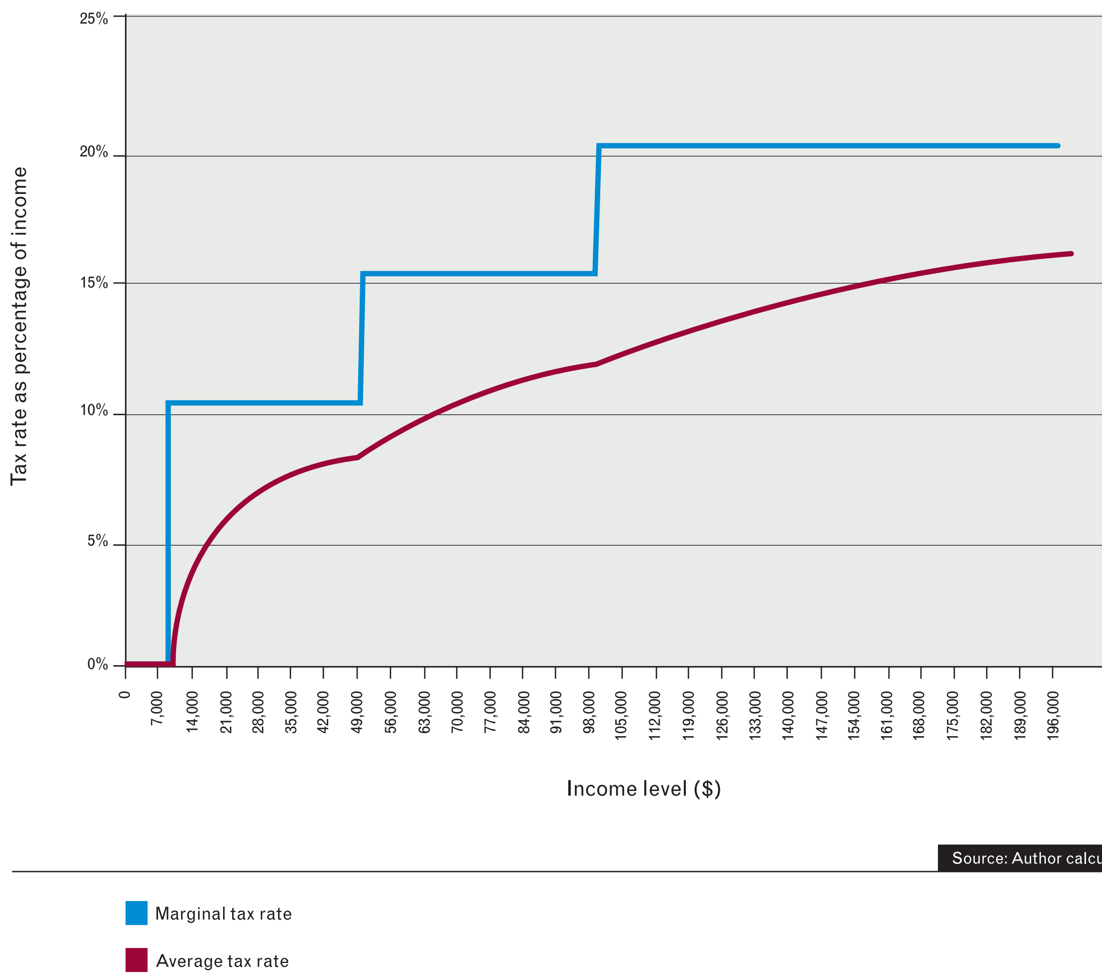
Determining progressivity

Income inequality is defined over the distribution of income, while progressivity is defined over the tax system as it applies at different income levels. Inequality measurement involves taking the distribution of incomes (whether pre-tax or post-tax) and transforming it into an index. Progressivity measures, in contrast, focus on the relative tax rates faced by various income groups:

"Comparing the rate of change in tax rates with the rate of change of the income being taxed yields a measure of progressivity termed the 'elasticity' of taxes with respect to income. A positive elasticity indicates a progressive tax structure, zero elasticity a perfectly flat structure, and negative elasticity a regressive structure. While income taxes are clearly progressive across all adjacent income groups, property taxes are consistently regressive" (Chawla & Wannell, 2003).

When looking at tax systems, it is necessary to consider the marginal and average tax rate. The marginal tax (MT) rate is the percentage of tax paid on the 'last' dollar of income. The

11 Marginal and average tax rates in a progressive system



Source: Author calculations

average tax rate (AT) can be calculated as the ratio of total tax paid on total income. The effective tax rate can be regressive, proportional, or progressive.

If a tax is proportional then the MT and AT will not change with income. For example, if an income tax has only one bracket equal to 10 per cent with no deductions, exemptions, allowances or credits then the MT and AT will be 10 per cent at any income – all income earners will pay 10 per cent of their income in taxes.

If a tax is progressive then the MT will rise with income level, and AT will rise with income. For example, a tax system with a $10,000 exemption (no taxes paid), 10 per cent on the next $40,000, 15 per cent on the next $50,000 and 20 per cent on all income greater than $100,000, is illustrated in **Figure 11** (this is a simplification of our income tax schedule). This example shows that in a progressive (bracketed) tax system, the average tax paid increases with income.

A tax is regressive if the average tax (AT) falls as income rises. For example, excise taxes are regressive, since all individuals pay the same rate irrespective of income. Thus, the proportion of income spent on this tax will decrease as earned income increases.

Why progressive tax?

Part of what we pay in taxation is to receive direct personal benefits, and part is to receive public benefits – to live in a civil society where there is law and order, equal opportunity, excellent public services, and quality living environments. The better off one is, the greater proportionally one can partake in the public benefits of the law, of crime prevention, of enforcement of contracts, of infrastructure, and other civil society attributes.

Economic literature also shows that the marginal utility of income diminishes with increased income. Higher income earners get less benefit from their last dollars of income (Layard et al., 2008). Therefore, distributing these dollars instead to lower income people will raise overall social wellbeing. In addition, the higher the income, the less sacrifice one makes in paying a given sum in taxes. Economists right back to Adam Smith have recognized the virtues of progressive taxation.

"The necessities of life occasion the great expense of the poor. ... It is not very unreasonable that the rich should contribute to the publick expense, not only in proportion to their revenue, but something more than in proportion."
Adam Smith, The Wealth of Nations (1784)

Modern optimal tax theory makes the case for the societal benefits provided by a progressive tax system. The *Mirrlees Review* concludes that a good tax system must be progressive (Mirrlees et al., 2010), noting that all tax systems strive for fairness or equity – with commonly stated goals of treating equal individuals equally (horizontal equity) and expecting those with a greater ability to pay to bear greater tax burdens (vertical equity) (Mirrlees et al., 2010, p. 551). Recent studies have found quantitative links between income inequality and low social welfare, lending support for a comprehensive and progressive tax system (The Equality Trust, 2013).

As noted earlier, Canadians' values support not only government and the need to address inequality, but also taxation of higher-income people at higher rates – the essence of a progressive tax system. More progressive income and corporate taxes are needed to offset the regressive impact of property and sales taxes so the overall tax system is fair and reflects Canadians' values.

The Carter Commission set out the fairness foundation of Canada's tax system in the 1960's. This Royal Commission report reflects Canadian values, and lays out context and principles underlying the Canadian tax system – its philosophy and structure (Canada, Royal Commission on Taxation, 1966 p. 17):

We believe that horizontal equity is achieved when individuals and families with the same gains in discretionary economic power pay the same amount of tax. By economic power we mean the power to command goods and services for personal use. By discretionary economic power we mean the residual power to command goods and services for personal use after providing the "necessities" of life and after meeting family obligations and responsibilities To be more concrete, some part of each family's income must be spent to provide food, clothing, medical expenses and other "necessities". The change in the discretionary economic power of the family is the income the family has available to spend or save after meeting these non-discretionary expenses.

We believe that vertical equity is achieved when individuals and families pay taxes that are a constant proportion of their discretionary economic power.

Both horizontal and vertical equity would be achieved by the adoption of a tax system that embodied the following principles:...

2. *All resident individuals and families should be taxed on a base that measures the value of the annual net gain or loss in the unit's power, whether exercised or not, to consume goods and services. Such a base would ignore the form of the gain or what was done to obtain the gain. We call this the comprehensive tax base. We also refer to it as "income" because this term is so commonly used. Income to us has, however, a much broader meaning than that ascribed to it under current law.*

3. *This comprehensive tax base should be subject to progressive rates of tax. The progressive rates would reflect the diminishing relative importance of non-discretionary expenditures for those with larger gains in economic power....*

Combined with a government expenditure system that provides relatively greater benefits for the poor than for the wealthy, a tax system with these characteristics would redistribute some of the power to consume goods and services in favour of the lowest income groups. We are firmly convinced that this redistribution is necessary if we are to achieve greater equality of opportunity for all Canadians and make it possible for those with little economic power to attain a decent standard of living. However, we are also convinced that the rates of tax which are applicable at any level of income should not be so high as to discourage initiative and thereby reduce the production of goods and services for Canadians.

The Carter Commission directed tax reform for a generation of Canadians. Many piecemeal reforms have been advanced in the 50 years since it was published. Subsequently, one of the major changes in Canada has been the urbanization of Canadians and the growth of large cities. This is where many public services are delivered. With this growth, our municipal tax systems have become more complex to account for the changing role of cities. New taxes (and user fees) have sprung up as particular jurisdictions have needed revenue sources. It is perhaps time for a new Royal Commission on tax policy in Canada (Brooks, 2013). This could be a comprehensive review of all taxes at all levels of government.

Principles of good taxation

A number of "principles" of good taxation have been identified over time. Despite being termed principles, not all of these are supported unanimously, and many reflect personal values and ideological preferences. For instance, the benefit principle, sometimes cited in support of property taxes, holds that taxes should be paid by people who benefit from services provided and in proportion to their consumption of those services. This is a useful aim for revenue sources, as it can help to reduce excessive consumption of goods and services. However, some advocates seem to support it for ideological reasons, arguing, for example, that user pay is the only system that reflects individual autonomy, and condemning the competing ability-to-pay principle as "absolutist" (Wagner, 1991, as cited in Duff, 2003).

Nevertheless, the different principles usually reflect a useful observation about the various effects of taxes. According to one recent formulation relevant to municipal revenues, taxes can be evaluated against four variables:

effectiveness, efficiency, equity, and affordability (Canada Mortgage and Housing Corporation, 2002). A tax is considered effective if it achieves its legislated objective, whether that is income redistribution, revenue generation, or economic management. Efficient taxes should be simple to understand, accountable, predictable from year to year, and generate minimal economic distortions and administrative costs. Taxes are equitable if the distributional impact of the tax is "fair". Tax affordability is evaluated by an individual's ability to pay the tax. Tax policy involves trade-offs. An ideal tax will satisfy each of these four conditions, although likely few, if any, do so.

The equity of a tax system – its "fairness" – has two dimensions, known in the economic literature as horizontal equity and vertical equity. Horizontal equity requires that individuals and families in similar economic circumstances pay the same taxes – that there aren't discriminatory policies forcing some to bear a higher cost. Vertical equity requires that those in different economic circumstances pay appropriately different tax rates. In Canada, income tax rates have long been progressive. The better off an individual or family is, the more they can afford to contribute proportionally to public expenditures. This way, lower-income families are taxed based on their ability to pay, and are still able to have basic goods and services.

Appendix 3

Municipal revenue sources by province/territory

Property taxes

All municipalities in Canada have access to the property tax. The property tax is the largest source of revenue for municipalities. For further information see p. 29-32 and 37-48.

Business taxes

Business taxes, which are property taxes paid by businesses, are currently available to municipalities in Newfoundland, Quebec, Manitoba, and Alberta. For further information see Residential and Business Taxation, p. 29-31.

Tax increment financing

Tax increment financing (TIFs) are available in Ontario, Manitoba, Saskatchewan, and Alberta. For further information see p. 31.

Area Improvement Taxes

The Area Improvement Tax is available in all provinces and territories except Newfoundland and New Brunswick.

User fees

User fees are available in all provinces and territories. For further information see p. 32-35 and p. 45-47.

Poll taxes

Newfoundland alone uses the poll tax. In 2012, 132 municipalities in Newfoundland were using the poll tax (British Columbia Ministry of Community, Sport and Cultural Development, 2012).

Land transfer taxes

Land transfer taxes are used in Nova Scotia, Quebec, Ontario, and Manitoba. For further information, see p. 31.

Development charges

All provinces allow municipalities to levy development charges or some form of levy for public development or infrastructure, although the rules surrounding how they are structured and what costs they can cover, vary from province to province. For further information see p. 33-34.

Hotel tax/Accommodation levy

All provinces except Ontario (and the territories) allow municipalities to levy a hotel or accommodations tax. Hotel taxes in Newfoundland and Nova Scotia are restricted to the cities of St. John's and Halifax, respectively, although there is a push to expand these powers to other municipalities (Municipalities Newfoundland and Labrador, 2014). For more information on hotel taxes, see p. 37.

Amusement taxes

Amusement taxes are available in Manitoba and Saskatchewan, as well as the cities of St. John's and Toronto, though neither of these cities makes use of amusement taxes. In Manitoba, the City of Winnipeg is currently the only municipality that collects amusement taxes. For further information, see p. 37-38.

Advertisement taxes

Advertisement taxes are used in British Columbia, and in Winnipeg and Toronto (see p. 38).

Fuel taxes

A fuel tax in addition to federal and provincial fuel taxes is applied in Montreal, Metro Vancouver and Victoria. See p. 38.

Income tax sharing

In Manitoba, all municipalities receive either a share of the provincial personal and corporate income taxes and the province's fuel tax, proportionate to their population, or a share of the provincial sales tax, whichever is greater. No other province or territory directs income taxes to municipalities. See p. 44.

Municipal finance authorities

Nova Scotia, New Brunswick, Ontario, Saskatchewan, Alberta, and British Columbia enable municipalities to borrow through municipal finance authorities, municipal finance corporations or similar bodies (see p. 41). In Prince Edward Island, municipalities can get provincial loans through the treasury board.

The discussion of powers here and elsewhere is for illustrative purposes only, and is not intended to be authoritative or comprehensive. Please consult the legislation in each province for the current and complete set of revenue sources available to municipalities.

Municipal Government Statutes by Province

Newfoundland and Labrador

- *Municipalities Act:* http://www.assembly.nl.ca/legislation/sr/statutes/m24.htm

Prince Edward Island

- *Real Property Tax Act:* http://www.gov.pe.ca/law/statutes/pdf/r-05.pdf
- *Municipalities Act:* http://www.gov.pe.ca/law/statutes/pdf/m-13.pdf

Nova Scotia

- *Municipal Government Act:* http://nslegislature.ca/legc/statutes/municipal%20government.pdf
- *Halifax Regional Municipality Marketing Levy Act:* http://nslegislature.ca/legc/statutes/halregmk.htm

New Brunswick

- *Municipalities Act:* http://www.gnb.ca/0062/pdf-acts/m-22.pdf
- *Community Planning Act:* http://www.gnb.ca/0062/pdf-acts/c-12.pdf
- *Real Property Tax Act:* http://www.canlii.org/en/nb/laws/stat/rsnb-1973-c-r-2/latest/rsnb-1973-c-r-2.html
- *Real Property Transfer Tax Act:* http://www.canlii.org/en/nb/laws/stat/snb-1983-c-r-2.1/latest/snb-1983-c-r-2.1.html

Quebec

- *An Act Respecting Municipal Taxation:* http://www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge.php?type=2&file=/F_2_1/F2_1_A.html
- *Municipal Code Act:* http://www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge.php?type=2&file=/C_27_1/C27_1_A.html
- *Municipal Powers Act:* http://www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge.php?type=2&file=/C_47_1/C47_1_A.html
- *Cities and Towns Act:* http://www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge.php?type=2&file=/C_19/C19_A.html
- *An Act Respecting Duties on Transfers of Immovables:* http://www2.publicationsduquebec.gouv.qc.ca/documents/lr/D_15_1/D15_1_A.htm
- *An Act Respecting the Québec Sales Tax:* http://www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge.php?type=2&file=/T_0_1/T0_1_A.html
- *Fuel Tax Act:* http://www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge.php?type=2&file=/T_1/T1_A.html

Ontario

- *Assessment Act:* http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_90a31_e.htm
- *Tax Increment Financing Act, 2006:* http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_06t33_e.htm
- *Planning Act:* http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_90p13_e.htm
- *Municipal Act, 2001:* http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_01m25_e.htm
- *Land Transfer Tax Act:* http://www.e-laws.gov.on.ca/html/regs/english/elaws_regs_910070_e.htm
- *Development Charges Act:* http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_97d27_e.htm

Manitoba

- *Municipal Act:* https://web2.gov.mb.ca/laws/statutes/ccsm/_pdf.php?cap=m225
- *Community Revitalization Tax Increment Financing Act:* http://web2.gov.mb.ca/bills/39-3/b004e.php
- *The Municipal Taxation and Funding Act:* http://web2.gov.mb.ca/laws/statutes/ccsm/m265e.php
- *The Planning Act:* http://web2.gov.mb.ca/laws/statutes/ccsm/p080e.php
- *Income Tax Act*: http://web2.gov.mb.ca/laws/statutes/ccsm/i010e.php

Saskatchewan

- *Cities Act:* http://www.qp.gov.sk.ca/documents/english/Statutes/Statutes/c11-1.pdf
- *Municipalities Act:* http://www.qp.gov.sk.ca/documents/English/Statutes/Statutes/M36-1.pdf
- *Planning Act:* http://www.qp.gov.sk.ca/documents/English/Statutes/Statutes/P13-2.pdf

Alberta

- *Municipal Government Act:* http://www.qp.alberta.ca/documents/Acts/m26.pdf

British Columbia

- *Community Charter:* http://www.bclaws.ca/Recon/document/ID/freeside/03026_00
- *Local Government Act:* http://www.bclaws.ca/EPLibraries/bclaws_new/document/LOC/freeside/--%20L%20--/Local%20Government%20Act%20RSBC%201996%20c.%20323/00_Act/96323_14.xml#section363
- *Hotel Room Tax Act:* http://www.canlii.org/en/bc/laws/stat/rsbc-1996-c-207/latest/rsbc-1996-c-207.html
- *South Coast British Columbia Transportation Act:* http://www.bclaws.ca/Recon/document/ID/freeside/00_98030_01#section27.1
- *Motor Fuel Tax Act:* http://www.bclaws.ca/Recon/document/ID/freeside/00_96317_01

Nunavut

- *Cities, Towns and Villages Act:* http://www.canlii.org/en/nu/laws/stat/rsnwt-nu-1988-c-c-8/latest/rsnwt-nu-1988-c-c-8.html
- *Hamlets Act:* http://www.canlii.org/en/nu/laws/stat/rsnwt-nu-1988-c-h-1/latest/rsnwt-nu-1988-c-h-1.html

  Property Assessment and Taxation Act: http://www.canlii.org/en/nu/laws/stat/rsnwt-nu-1988-c-p-10/latest/rsnwt-nu-1988-c-p-10.html

Yukon

- *Municipal Act:* http://www.gov.yk.ca/legislation/acts/municipal.pdf
- *Assessment and Taxation Act:* https://www.canlii.org/en/yk/laws/stat/rsy-2002-c-13/latest/rsy-2002-c-13.html

Northwest Territories

- *Cities, Towns, and Villages Act:* http://www.justice.gov.nt.ca/pdf/ACTS/Cities%20Towns%20and%20Villages.pdf
- *Hamlets Act:* http://www.canlii.org/en/nt/laws/stat/snwt-2003-c-22-sch-c/latest/snwt-2003-c-22-sch-c.html
- *Property Assessment and Taxation Act:* http://www.canlii.org/en/nt/laws/stat/rsnwt-1988-c-p-10/latest/rsnwt-1988-c-p-10.html
- *Planning Act:* http://www.canlii.org/en/nt/laws/stat/rsnwt-1988-c-p-7/latest/rsnwt-1988-c-p-7.html

Charters and special municipality statutes

- *Vancouver Charter*: http://www.bclaws.ca/Recon/document/ID/freeside/vanch_00
- *City of St. John's Act*: http://www.assembly.nl.ca/legislation/sr/statutes/c17.htm
- *City of St. John's Municipal Taxation Act:* http://www.canlii.org/en/nl/laws/stat/snl-2006-c-c-17.1/latest/snl-2006-c-c-17.1.html
- *Charter of Ville de Montréal*: http://www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge.php?type=2&file=/C_11_4/C11_4_A.html
- *City of Toronto Act*: http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_06c11_e.htm
- *City of Winnipeg Charter Act*: http://www.winnipeg.ca/interhom/pdfs/news_releases/CityofWinnipeg_CharterAct.pdf
- *Charlottetown Area Municipalities Act*: http://www.gov.pe.ca/law/statutes/pdf/c-04_1.pdf
- *NWT Charter Communities Act*: http://www.canlii.org/en/nt/laws/stat/snwt-2003-c-22-sch-a/latest/snwt-2003-c-22-sch-a.html

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