

The case for growing the Gas Tax Fund

A report on the state of municipal finance in Canada



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Table of Contents

| | |
|---|-----------|
| Introduction | 2 |
| 1. Where do municipalities get their funding from? | 4 |
| 2. How do municipalities budget? | 8 |
| 3. How are infrastructure projects funded? | 12 |
| 4. What's the role of municipalities in the economy? | 16 |
| 5. Looking forward | 18 |
| Conclusion | 22 |
| Endnotes | 23 |

Introduction

Municipalities are Canada's builders. Every single day, Canadian families and businesses rely on municipal transportation networks, public safety services, recreation, social and cultural facilities, clean water, sanitation, and far more.



All told, municipalities manage some 60 percent of the public infrastructure and amenities that drive our economy and quality of life. Local governments make people's lives better, and local solutions have significant regional, provincial and national impact.

But the reality is that municipalities are constantly doing more with less, and unsustainable fiscal tools make it hard to plan for the longer term. Receiving only 10 cents on every tax dollar⁰¹, local governments face huge challenges in maintaining current infrastructure—and this is not to mention growing needs.

The role of local government continues to expand and evolve, with municipalities taking on greater responsibilities and leadership in a variety of areas including economic development, housing and social infrastructure. And more than ever, there is an urgent need to rapidly scale-up climate adaptation projects to improve community resilience.

Faced with a rapidly changing operating environment, and a need for smarter policies, it seems obvious that local governments should be at the forefront of political and policy discussions. We live in communities, play in communities and work in communities.

Whether we talk to town councillors in the very smallest communities or elected officials in big cities, the same issue comes up over and over again. Municipalities need better and more reliable fiscal tools in order to tackle the daily challenges that build better lives.

For all their importance in our lives, we treat local governments much the same as we did in 1867.

We wouldn't regulate ride sharing, autonomous vehicles or even public transit with the rules we applied to the horse and buggy, so why do we still apply the same tired ways of thinking about our municipal governments that we did in the mid-19th century?

As Canada's economy shifts from producing goods to providing services in the knowledge and digital economies, the role of municipalities will become even more important than it is today. And yet, our local governments don't have enough funding to provide the core services we expect, let alone to meet the challenges of the future.

Property taxes, which account for nearly half of municipal revenues, are not a viable source of increased revenues given the challenges many households face with stagnating wages and increased costs in a range of other areas such as transportation, energy, food and childcare. Moreover, non-residential property tax revenues could start to erode as the nature of work changes and physical space becomes less tied to economic value.

So, what can be done about these challenges? This paper seeks to provide a plain-language explanation of how municipalities are funded and how they budget. It then explores how infrastructure projects are funded and some of the future revenue challenges facing municipal governments. It concludes by exploring how an expansion of the federal Gas Tax Fund, which has proven to be an effective, targeted means of building and maintaining the infrastructure that matters to Canadians, could be enhanced and expanded.



1. Where do municipalities get their funding from?

Municipal governments in Canada rely primarily on three fiscal tools—property taxes, user fees and federal and provincial transfers—as sources of funding. As of 2016, municipal revenue sources in Canada were distributed as follows on a national average basis (which has not changed substantively since 2008):⁰²

Property tax
(and higher in many provinces)

48%

Government transfers
(federal and provincial)

19%

User fees

22%

Taxes on goods & services
(including lot levels)

8%

Other revenues

3%

Canada is an outlier among advanced economies in its reliance on property taxes to fund local governments. In 2017, local property tax revenues accounted for 3.2 percent of GDP in Canada, one of only two Organisation for Economic Cooperation and Development (OECD) member nations with a share above 3.0 percent. At 3.3 percent, only France had a higher share, while the OECD average stood at 1.1 percent, or one-third of the rate in Canada [See Chart 1]. As a share of local government tax revenue, property taxes accounted for over 97 percent of revenues in Canada, compared to 70.7 percent in the US.

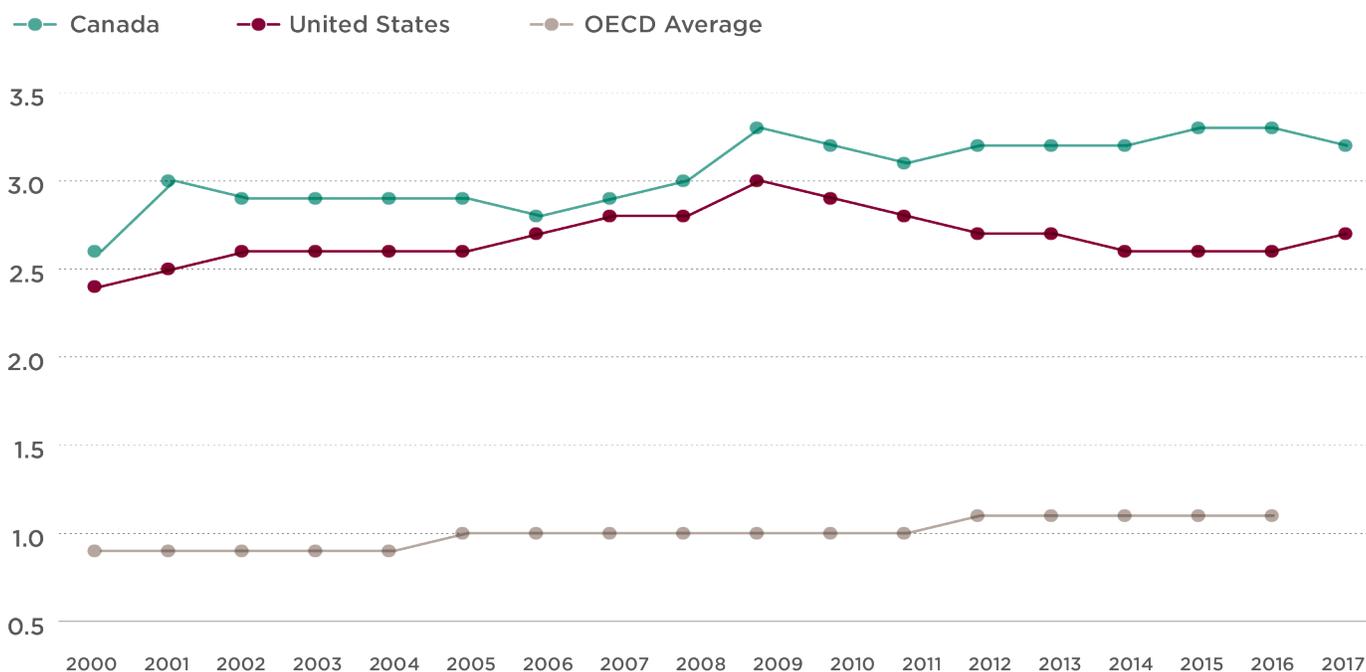
Why does this matter? There are a number of key challenges with being overly reliant on property taxes. One is that the average household in Canada is challenged to meet rising costs in a range of areas, and this is particularly the case for low-income households. Therefore, increases in property tax can disproportionately and regressively impact those least able to afford it.⁰³

Property taxes levied on businesses may face an existential threat in the digital era, when the value and location of land is not as tied to economic value as it has been historically. For example, the rise of teleworkers and mobile work means that traditional large office towers may not be as necessary in the past. This would threaten a reliable source of non-residential property tax revenues.⁰⁴

The rise of e-commerce (sales for Canadian online retailers doubled between 2012 and 2017), could similarly mean the demise of many bricks-and-mortar retailers and their associated commercial property tax revenues. This would transfer greater responsibility onto the residential tax base for services that were previously funded from non-residential taxes. Repurposing commercial space for residential development may be possible where local demand exists, but this may not generate the same level of property tax revenue since residential property tax rates are often set lower than commercial rates. Municipalities without a growing demand for

Chart 1

Property tax revenues of local governments as a share of GDP (2000-17, percent)



Source: OECD, Revenue Statistics - OECD Countries: Comparative Tables



residential development could suffer an even larger loss of revenue.

Finally, property taxes are not, by their design, intended to fund a broad range of services that are increasingly a part of municipal mandates. Services that redistribute income (e.g. social housing, childcare, social assistance) and regional services (e.g. transit, culture, economic development) are most appropriately funded through other financial tools. According to experts in municipal finance, income tax revenue should fund redistributive services because it is the most progressive tax available, with intergovernmental transfers playing a key role in funding regional projects that spill over municipal boundaries.⁰⁵

Taken together, these challenges should be a signal that over-reliance on the property tax is a red flag for municipalities in Canada. While all 35 OECD nations levy property taxes, most nations also provide for local government revenue raised from income, profits and capital gains (both individuals and corporations). These types of taxes account for over 50 percent of local tax revenues in 12 of 35 countries, including in Japan and in 11 European countries [see Table 1].

In a world of increasing complexity, with a broader array of service pressures falling on the shoulders of municipalities, the risks of property-based revenues facing significant pressures and constraints is real, and exploring more diverse funding sources is simply prudent.

For Canadian local governments, this is a conversation that needs to occur on two fronts. Provincial/territorial governments have the jurisdictional authority under the Constitution to provide municipal governments with new revenue tools. The federal government's role in municipal finance, meanwhile, is focused on transfers and funding arrangements that benefit local governments.

Table 1

Local government tax revenue sources for 35 of the 36-member countries of the OECD (2017)

| | Property taxes | Total taxes on goods and services | Taxes on income, profits and capital gains |
|-----------------|----------------|-----------------------------------|--|
| Australia | ✓ | ✗ | ✗ |
| Austria | ✓ | ✓ | ✗ |
| Belgium | ✓ | ✓ | ✓ |
| Canada | ✓ | ✗ | ✗ |
| Chile | ✓ | ✓ | ✗ |
| Czech Republic | ✓ | ✓ | ✗ |
| Denmark | ✓ | ✗ | ✓ |
| Estonia | ✓ | ✓ | ✗ |
| Finland | ✓ | ✗ | ✓ |
| France | ✓ | ✓ | ✗ |
| Germany | ✓ | ✓ | ✓ |
| Greece | ✓ | ✓ | ✗ |
| Hungary | ✓ | ✓ | ✗ |
| Iceland | ✓ | ✓ | ✓ |
| Ireland | ✓ | ✗ | ✗ |
| Israel | ✓ | ✓ | ✗ |
| Italy | ✓ | ✓ | ✓ |
| Japan | ✓ | ✓ | ✓ |
| South Korea | ✓ | ✓ | ✓ |
| Latvia | ✓ | ✗ | ✓ |
| Lithuania | ✓ | ✓ | ✗ |
| Luxembourg | ✓ | ✗ | ✓ |
| Netherlands | ✓ | ✓ | ✗ |
| New Zealand | ✓ | ✓ | ✗ |
| Norway | ✓ | ✗ | ✓ |
| Poland | ✓ | ✗ | ✓ |
| Portugal | ✓ | ✓ | ✓ |
| Slovak Republic | ✓ | ✓ | ✗ |
| Slovenia | ✓ | ✓ | ✓ |
| Spain | ✓ | ✓ | ✓ |
| Sweden | ✓ | ✗ | ✓ |
| Switzerland | ✓ | ✗ | ✓ |
| Turkey | ✓ | ✓ | ✓ |
| United Kingdom | ✓ | ✗ | ✗ |
| United States | ✓ | ✓ | ✓ |

Note: Taxes must account for 2 percent or more of total local government tax revenue to be considered as levied in the table.**Source:** OECD, Revenue Statistics—OECD Countries: Comparative Tables. <https://stats.oecd.org/index.aspx?DataSetCode=REV>.

2. How do municipalities budget?

Municipalities in Canada use budgets for the same purposes as any other government. That is, broadly, to forecast planned capital investments and operating expenditures and expected revenues, provide accountability to citizens, and to ensure that the municipality is living within its means. There are two primary elements of a municipal budget:

- ▶ **Municipal operating budgets cover day-to-day expenses such as salaries, the purchase of services and supplies and maintenance costs. Municipalities have a legislated mandate to run balanced operating budgets.**
- ▶ **Municipal capital budgets detail plans for the investment and financing of capital infrastructure and public amenities such as roads, community facilities and machinery and equipment, as well as the ongoing repair and rehabilitation of existing assets.**

In practice, budgeting for municipalities is increasingly challenging due to the increased scope of responsibilities they must deal with and

their limited revenue tools. Table 2 below sets out at a high-level the types of service responsibilities that municipalities in Canada deliver

Table 2

Some municipal government responsibilities⁰⁶

| | Examples |
|--------------------------|---|
| Security | Police, fire, emergency planning |
| Transportation | Public transit, local roads, sidewalks, parking |
| Recreation and culture | Museums, libraries, convention centres, community centres, recreation facilities, parks |
| Public utilities | Public lighting, water supply and distribution, solid waste management, sewage collection and treatment |
| Health care | Ambulance services; provision of public health services such as vaccinations |
| Planning and development | Permitting, zoning, licensing, municipal land use planning; local economic development |
| Social services | Social housing and homelessness prevention programs; childcare or other social services |

Note: Cities' responsibilities may slightly vary from province to province, for example, social housing and public health are only mandated responsibilities for municipalities in Ontario.

These responsibilities are ever evolving. In recent years, for example, local governments are increasingly expected to shoulder responsibilities tied to key national priorities such as tackling gun violence and regulating legalized cannabis, to addressing the opioid crisis and helping newcomers thrive in our communities. Most urgently, local governments are taking on growing responsibilities related to climate change mitigation and adaptation. This includes responding to more frequent and severe flood events and improving infrastructure resiliency, while taking concrete action to reduce greenhouse gas emissions at the local level. And yet, as outlined earlier, the revenue tools available to meet these challenges are limited and access to new sources of revenues is controlled by provincial governments. As noted by the Senate of Canada in 2007, “there is widespread agreement that municipalities do not have sufficient revenue sources to meet their growing expenditure responsibilities.”⁰⁷

Despite their increased responsibilities, local governments in Canada have been incredibly disciplined at keeping their spending levels in line with inflation. Between 2008 and 2016, per capita municipal expenditures rose from \$1,727 to only \$1,799 in real dollars, or an increase of only four percent in eight years.⁰⁸

When it comes to capital budgeting, municipalities have three options for funding long-term infrastructure investments. First, save for future projects from the operating budget and development contributions, and then invest using accumulated reserves. Second, take on debt to finance projects, with incremental financing costs funded through the operating budget. Third, utilize a ‘pay as you go’ approach that funds project costs through current-year operating revenues without taking on debt. Local governments use a mix of these strategies to fund their long-term capital plans, while also leveraging contributions

from other orders of government from predictable transfers and project-specific grants.

Some provincial legislation sets debt limits for municipalities at a particular amount (e.g., Alberta municipalities’ limit is twice their annual revenue), while other municipalities self-impose restrictions on their borrowing activities for capital (e.g., Toronto’s debt service costs should not exceed 15 percent of property tax revenues).⁰⁹ Most local governments in Canada also have corporate debt management plans that outline approved uses and administrative procedures related to capital financing and debt.

It’s also important to note that many local infrastructure needs are simply to “keep the lights on,” or keep existing infrastructure in a state of good repair. For example, replacing and repairing aging sewer and water lines is a major cost pressure for municipal governments. Halifax’s 2,000 kilometres of pipes needed an estimated \$2.6B of work as of 2016, not including any expansion of capacity through new treatment plants or upgrades to improve resiliency in the face of extreme weather events.¹⁰ Similarly, fleet replacement of aging buses that provide public transit across the country is a necessary cost to simply maintain existing levels of service.

“ There is widespread agreement that municipalities do not have sufficient revenue sources to meet their growing expenditure responsibilities.”

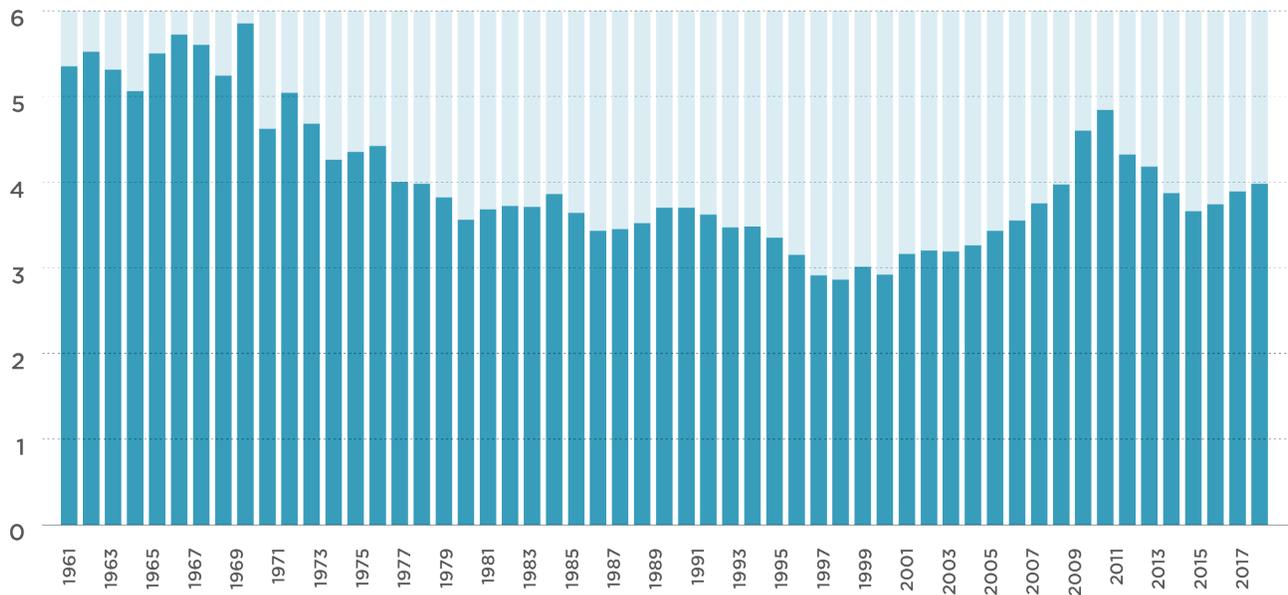


3. How are infrastructure projects funded?

Canada's infrastructure needs are significant. A variety of estimates peg the deficit in infrastructure at between \$50B and \$570B, with most averaging between \$110B and \$270B, which represents both investments in existing infrastructure repair and to build new infrastructure to meet current needs.¹¹ These deficits are a result of declining investments in infrastructure in the 1980s and 1990s, as demonstrated in Chart 2 below. This lack of funding resulted in a backlog of significant state of good repair and maintenance requirements for public infrastructure. Investing an additional one percent of GDP—the gap between current levels and the level of investment two decades prior—is equal to spending an additional \$22 billion each year on public infrastructure renewal and expansion.

Chart 2

General government fixed capital formation as a percentage of GDP (1961-2018)¹²



For Canadians, this deficit isn't merely a paper accounting exercise. It means clogged roads, bridges and transit that hinder the movement of vital goods and people trying to get to work or around their community. It means mounting challenges with water quality issues and waste treatment, and a lack of spaces for children and their families to play. It also increasingly means a lack of protection against flooding and other weather emergencies. The impact of these services is not just felt locally – local government infrastructure supports economic development at the regional, provincial and national level.

Canadian local and provincial governments play a much larger role relative to the federal government in public infrastructure investment than they do in peer jurisdictions such as Australia, Germany and the U.S.¹³ This represents a dramatic shift from the situation in the 1950s, when the federal government owned most public infrastructure and municipal governments the least. Though estimates of the precise amounts of public infrastructure owned and maintained by municipalities vary, the number today is somewhere between 50 percent and 60 percent, while the federal share is roughly two percent.¹⁴

Canadian sub-national governments also invest a larger share relative to their economic capability,

as measured by GDP, than other OECD peer jurisdictions. In 2012, public investments by Canadian sub-national governments represented 3.8 percent of their GDP, highest among 33 OECD peer jurisdictions and twice the OECD average of 1.9 percent.¹⁵

This growing responsibility for core infrastructure needs places significant strains on local governments in Canada, which do not have the same revenue-raising capacity as their federal and provincial peers. In the wake of significant increases in public infrastructure investment by the federal government after the 2008-09 financial crisis, the sum of federal investments increased from \$600M annually in 2003-04 to \$5.5B annually by 2014-15. Meanwhile provincial and municipal investments more than doubled between 2003 and 2013 from \$14.5B to \$29.5B, with municipal investments representing more than two-thirds of these figures.¹⁶

Municipalities are typically responsible for all operating and maintenance costs related to infrastructure projects built with federal support. Federal funding can only be applied to eligible capital costs, with operating costs deemed ineligible. This adds pressure on operating budgets in cases where a new source of local revenue has

Table 3Government roles and competencies, infrastructure¹⁷

| | Municipal governments | Provincial governments | Federal governments |
|--------------------------------------|---|---|--|
| Public infrastructure ownership | Major—including local roads and bridges, public transit, sewers, water supply systems | Moderate—including regional roads, bridges and highways, some regional transit | Minor—including some airports, ports and border infrastructure |
| Greatest competencies by government* | Strong view of local economy including management of assets. Insights on specific conditions and needs within a community | High-level view of economic strengths and opportunities within a region. Defines provincial and regional strategic priorities | Broad view of national objectives and international trade agreements |

not been identified to support these increased operating costs. The table above illustrates what infrastructure ownership responsibilities look like for each order of government as well as the unique insights and strengths each brings to the infrastructure funding and operations table.

The challenges municipalities face with respect to infrastructure would be significant enough if they were just restricted to an outsized responsibility set against insufficient revenue sources. The design of federal and provincial infrastructure programs can either exacerbate these challenges, or if designed properly, improve the sustainability of local investments in core infrastructure.

Proven approaches to infrastructure funding share consistent attributes: permanent or long-term funding timeframes, dedicated allocation-based funding that eliminates uncertainty about the amount of funding a community will receive, and flexibility to direct funding towards locally identified needs and priorities. These components are at the core of two successful federal infrastructure programs: the federal Gas Tax Fund (GTF) and the Investing in Canada Plan’s Public Transit Infrastructure Stream.

The federal approach to transit funding, recently reaffirmed and expanded under the Invest in Canada Plan, provides each transit system a long-term, equitable and predictable

stream of revenue to invest in improving and expanding public transit at the local level. The Public Transit Infrastructure Stream includes \$20.1B over 10 years in dedicated funding, and is the key source of funding for transformative transit expansion projects currently underway including new bus rapid transit, light rail transit and subway lines and extensions.

The GTF was originally established in 2005, and provides municipalities with over \$2B per year for infrastructure investments, allocated on a per capita basis. In 2013 the GTF was indexed so that it would grow at two per cent per year, with funding increases implemented in \$100M increments. Within broad eligibility criteria of municipal infrastructure (18 eligible project categories exist), local governments have the ability to apply this funding fully to projects with no cost-sharing or stacking limits, pool it, bank it, and borrow against it, which provides significant flexibility and autonomy when compared with other infrastructure funding programs.

The majority of local governments use the GTF to fund state-of-good-repair investments in transportation (transit and roads/bridges) and water infrastructure. For example, in 2018, 73.8 percent of GTF funding supported local road and bridge projects in Manitoba¹⁸, while in Saskatchewan local roads and bridges made up



39 percent and wastewater 24 percent.¹⁹ The GTF is dedicated to transit state of good repair and fleet renewal projects in many large cities. In small and rural communities, the GTF is typically the only permanent and flexible source of federal funding for local roads and bridges.

The GTF, as a flexible tool, is only a small fraction of overall government transfers – less than two percent of municipal revenues nationally, where government transfers are 19 percent in total. The 2019 federal budget announced a one-time transfer through the GTF of \$2.2B for short-term infrastructure priorities.²⁰ Evaluations of the GTF have found it to be an effective program that provides much-needed flexibility and predictability for local governments, while also being efficient, accountable and cost-effective.²¹

The transit and GTF approaches are important examples of how funding agreements and partnerships should be structured. We know that large-scale infrastructure projects can take years to plan and execute. Funding arrangements that

“ The Gas Tax Fund is an effective program that provides much-needed flexibility and predictability for local governments, while also being efficient, accountable and cost-effective.”

reflect this reality through long-term, predictable funding help ensure that projects can be completed on time and on budget. Furthermore, given the outsized municipal role in owning and maintaining our public infrastructure, we need to ensure that municipal priorities are at the forefront of infrastructure project decisions.



4. What's the role of municipalities in the economy?

It's clear that municipal governments are increasingly taking on a larger role in our society—more residents, more responsibility for key program and policy areas such as infrastructure, climate change adaptation and housing and a critical role in forging and sustaining connections between residents through fostering livable communities. Yet, due to outdated governance arrangements, local governments face challenges in discharging their core functions, let alone their growing mandates and responsibilities. Nowhere is this more apparent than the disconnect between how municipalities contribute to our economic growth versus how they benefit from that growth.

While municipalities own and maintain the majority of Canada's public infrastructure, they see limited return on investment generated by infrastructure investments, in terms of direct impact on municipal balance sheets. By some estimates, between 30-35 percent of infrastructure investments are recovered by the federal and provincial governments (roughly split 50/50) through higher personal, corporate and indirect taxes.²² Meanwhile, municipal governments see 0.001% of the benefits of these investments due to a lack of access to revenue tools linked directly to economic growth and activity.²³

And these investments have proven to be a key driver of economic growth in Canada. A Statistics Canada report estimates that half of productivity growth in Canada between 1961 and 2006 stems from public infrastructure, with a peak contribution in the 1960s and 1970s.²⁴ Estimates of the impacts on GDP of investments in infrastructure range from a multiplier of 1.14 to 1.78, depending upon the methodology and assumptions employed.²⁵ Investments in infrastructure rank as among the best returns on investment of public funds, outstripping tax measures and on par with spending targeted to low-income households and the unemployed.²⁶

We also know that infrastructure investments are an important spur of job growth. One American study estimates that 18,000 jobs are created by every \$1B in new infrastructure spending, including indirect jobs at supplier firms and the jobs created by enhanced economic activity in local economies.²⁷ Canadian studies have estimated a short-term employment multiplier of between 3.6 and 13.5 jobs per \$1M invested, which would translate to between 3,600 and 13,500 jobs per \$1B in infrastructure investments.²⁸

Longer-term benefits stemming from infrastructure are even more significant. The Canadian Centre for Economic Analysis (CANCEA) estimated a \$16.3B dollar increase in Ontario's GDP and 85,000 person-years of employment for each billion dollars of infrastructure spending over a 30 year time horizon, along with a \$3.3B increase in federal

and provincial tax revenues.²⁹ A more modest estimate by the Centre for Spatial Economics found a \$7.4B GDP increase and 22,600 jobs created within the same parameters, along with a \$1.1B boost in tax revenues.³⁰

It is clear that significant benefits of infrastructure investments accrue to not just the economy as a whole, but also the balance sheets of the federal and provincial governments. The question then becomes, why are municipal governments, who play such a vital role in investing in and maintaining our infrastructure, not able to reap their fair share of those benefits? And, again, we find the answer rooted in the limited revenue tools available to local governments in Canada, who are so heavily reliant on property-based revenue tools that are not tied to broader economic growth.

While the GTF is an effective and useful tool to provide long-term, sustainable funding to municipalities, it too is hampered by its relatively limited size and a two percent annual increase that doesn't keep pace with other economic fundamentals such as wage increases and material costs for infrastructure projects.

For example, infrastructure construction costs for the municipal projects carried out by the City of Ottawa increased by 24 percent between 2010 and 2018, which averages out to a three percent increase per year over the time-frame, outstripping the growth in the GTF.³¹

More broadly, the increase in construction costs between Q1 2017 and Q1 2018 in eleven large Canadian cities was 7.3% for residential buildings and 2.7% for non-residential buildings. Over a longer time frame, between 2002 and 2017, non-residential construction costs in Canada's seven largest cities increased by 63 percent, or more than four percent per year. While these figures are not a direct proxy for public infrastructure costs, Statistics Canada noted that material costs (which would be relevant to any project) for lumber, concrete and steel were a driver of the increase.³²



5. Looking forward

We are entering an era of disruption. Canadians are witnessing the impacts of globalization, new technologies, climate change and other factors first hand. This spring's record flooding in the Ottawa valley, forest fires again endangering communities across Alberta and B.C. and last fall's announcement of GM's plant closure in Oshawa are recent examples of dramatic changes in how we live and work. And these changes seem to be occurring with more regularity. How will artificial intelligence reshape the nature of jobs and skills? Will the rise of China and India as economic superpowers be an opportunity Canadian firms are positioned to seize, through our infrastructure and our ideas?

As we confront a new normal, we increasingly realize that the regulatory and policy frameworks of the past aren't going to be up to the tasks of dealing with today's challenges. When Uber and Airbnb started operating in Canadian cities in recent years, policymakers had to make tough decisions about whether to allow these platforms to operate, and if so, under what rules. Facebook and Google are at the forefront of international conversations about what kinds of information and advertising should be allowed during election campaigns and which should be prohibited, which is new terrain for politicians and the public alike.

We also need to realize that our new normal is going to see economic growth that will only be half as strong over the next 50 years as it was

over the past 50 years, which means our policies, programs and strategies are going to have to be smart, targeted and effective.

The thorny challenge facing local governments in Canada—how to do more, with less—is only likely to become more acute over time. How we create value and work in the modern economy is likely to put even further stress on the revenue sources of municipal governments.

A recent study by the Mowat Centre conducted in partnership with Peel Region explored the impacts of the digital economy on the Region's revenue sources and concluded that land-based approaches to value which underpin much of the municipal revenue base (e.g., property taxes and

development charges) are becoming less relevant in the digital era.³³ In particular, key trends to note in this regard include:

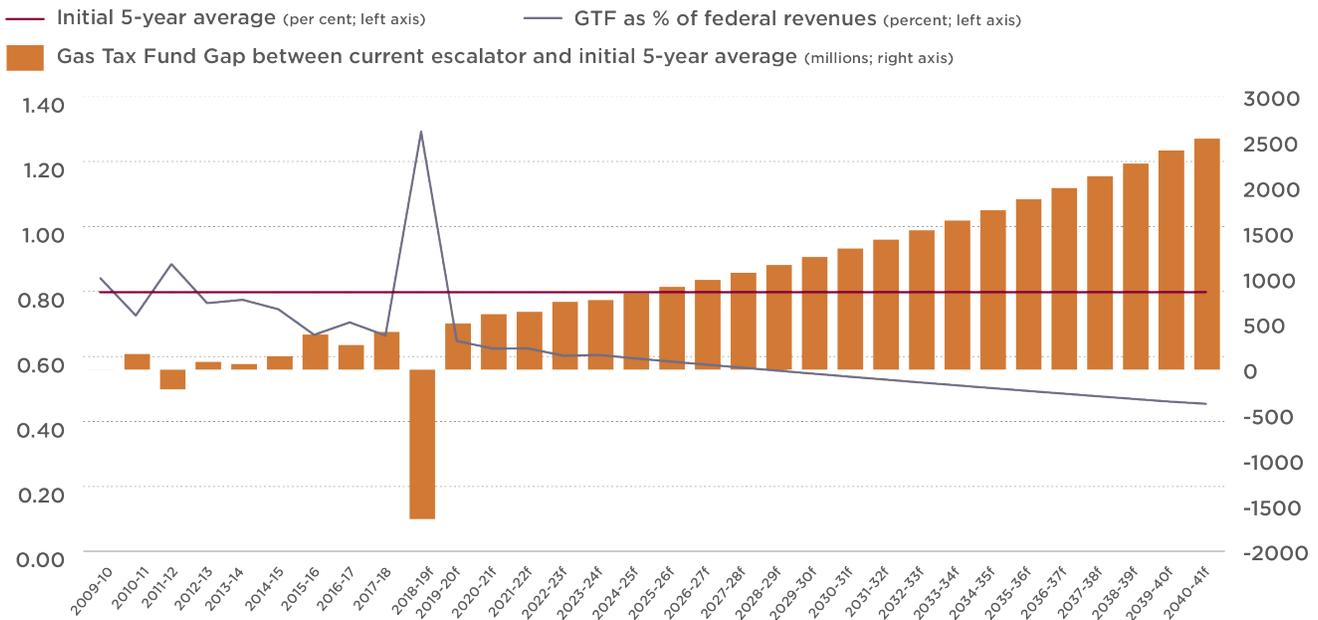
- ▶ Canada’s economy continues to shift from goods-production to service-provision—employment has dropped from 35 percent of workers in 1976 to 21 percent in 2018 in goods-producing sectors³⁴;
- ▶ The rapid increase in e-commerce is reducing the need for physical retail spaces in communities across Canada;
- ▶ Shrinking workspaces driven by technology, more office workers, telecommuting and hot-desking are reducing the need for employment-lands. In Peel Region, for example, the growth in employment land consumption dropped from 62.7% between 1994 and 2004 to 3.4% between 2004 and 2016; and
- ▶ The share of revenues many local governments can realize from non-residential property tax is in a steady state of decline, putting even more pressure on residential ratepayers. Peel Region has seen revenue shares from non-residential taxes drop from 41% in 2006 to 36.4% in 2018, with residential property taxes increasing from 59 to 63.6% over the same time-frame.
- ▶ A recent study commissioned by the Union des municipalités du Québec found that the loss of 2,000 businesses deprived municipalities of \$3 billion in land value in 2016 alone.³⁵

As a result, many municipalities could soon be forced to raise property tax rates on residential rate-payers to compensate for declining revenues from non-residential property taxes and development charges.

In 2017-18, the \$2.07B the federal government flowed to municipalities through the GTF represented 0.67% of federal revenues, while the one-time 2018-19 doubling of the GTF to \$4.3B shifted the Fund to 1.29% of revenues. In the first five years that followed the GTF becoming permanent, the total funds transferred to municipalities, on average, represented 0.8% of federal revenues. In 2017-18, the percentage had declined to 0.67%.

Chart 3

Projection: GTF growth as a share of federal revenue





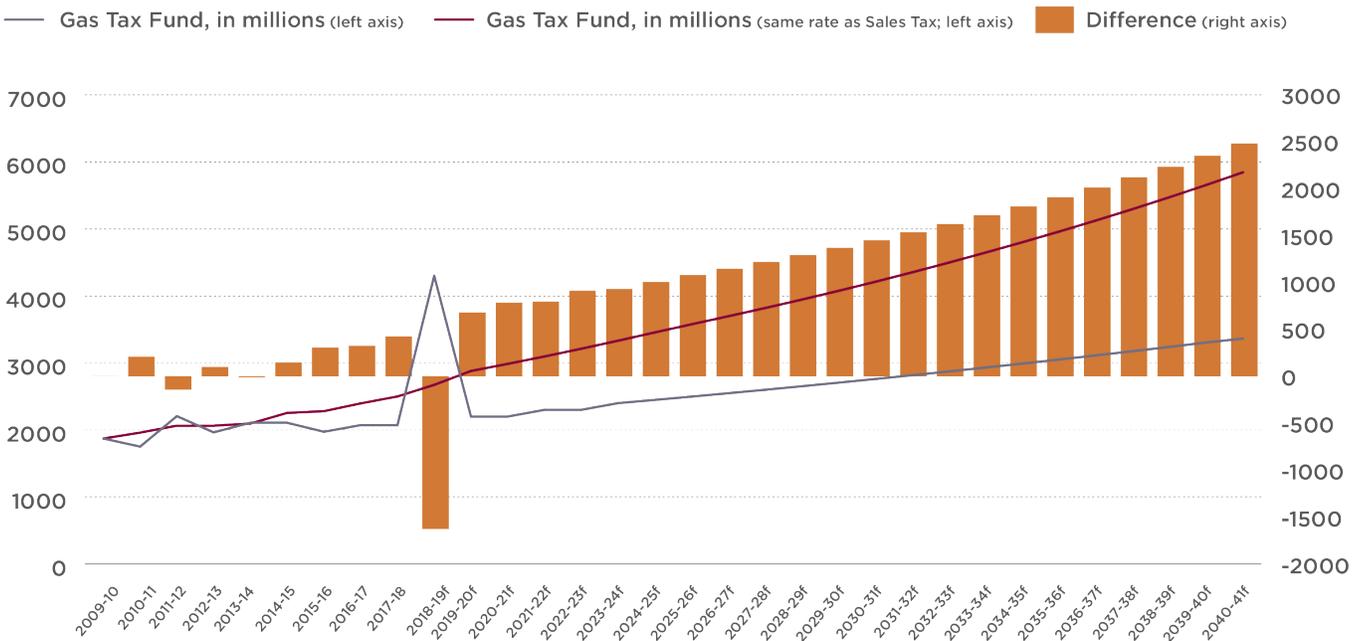
Based on projections completed by the Conference Board of Canada (CBOC) for FCM, should the GTF fund continue to grow in its current state, by 2040/41, it will represent only 0.46% of federal revenues—over \$2.54 billion less than were it 0.8%, as represented below.

In the same analysis completed by CBOC for FCM, the growth of the GTF was examined in relation to federal sales tax, due to its close relationship with economic growth. Were the GTF to grow at the same rate as projected for the federal sales tax, this would represent an additional \$2.48 billion in funds for municipalities to invest in delivering infrastructure.

If the one-time GTF increase was made a permanent expansion, and the indexation of the fund was raised to 3.5% to better reflect infrastructure costs, then municipalities would be yielding over \$4.6B in funding by 2020-2021. The impacts of this investment would compound over time. A permanent expansion with a 3.5% escalator would result in \$8.85B in annual funding by 2039-40 (which would still only represent 1.24% of federal revenues), compared to only \$3.3B if the GTF continues on its current track.

Chart 4

Projection: GTF and federal sales tax growth



Large city

If we were to take a city with a population of one million people, that city would have received approximately \$60M in GTF in 2018-19, and \$120M with the one-time doubling in 2019-20. Projecting out three scenarios to 2039-40, this city would see the following funding amounts under three different scenarios:

| | Status quo | Doubling + 2% status quo escalator | Doubling + 3.5% escalator |
|---------------------------|----------------|------------------------------------|---------------------------|
| Funding received, 2039-40 | \$90.9M | \$181.9M | \$247.1M |

Mid-sized city

If we were to take a city with a population of 150,000 people, that city would have received approximately \$8.5M in GTF in 2018-19, and \$17M with the one-time doubling in 2019-20. Projecting out three scenarios to 2039-40, this city would see the following funding amounts under three different scenarios:

| | Status quo | Doubling + 2% status quo escalator | Doubling + 3.5% escalator |
|---------------------------|----------------|------------------------------------|---------------------------|
| Funding received, 2039-40 | \$12.8M | \$25.2M | \$33.8M |

Small municipality

If we were to take a municipality with a population of 5,000 people, that municipality would have received approximately \$300,000 in GTF in 2018-19, and \$600,000 with the one-time doubling in 2019-20. Projecting out three scenarios to 2039-40, this municipality would see the following funding amounts under three different scenarios:

| | Status quo | Doubling + 2% status quo escalator | Doubling + 3.5% escalator |
|---------------------------|------------------|------------------------------------|---------------------------|
| Funding received, 2039-40 | \$454,000 | \$891,000 | \$1.2M |

Clearly, the approaches that build on a permanent expansion of the GTF would provide significantly more flexibility to a municipality to address infrastructure gaps, and the effects of increasing the escalator are dramatic.

Formal reviews of the GTF have been very positive.³⁶ A 2015 federal evaluation found that the GTF’s numerous project categories “addresses the range of infrastructure needs of Canadian municipalities, regardless of their size.” In terms of the performance of the program, the evaluation found that program outcomes were advanced, particularly in terms of access to funding for key infrastructure projects. The economy of the program was also lauded, with

“minimal overhead costs for administration, effective governance, and jurisdictional flexibility for program administration” being highlighted. The five-year cost to deliver one dollar of GTF funding was found to be less than one cent.³⁷

The five-year cost to deliver one dollar of GTF funding was found to be less than one cent.



Conclusion

Local leaders make the most of outdated tools to build better lives. But to renew and increase the resiliency of the infrastructure that supports Canadians' quality of life, it's time to modernize their toolbox.

The best funding tools are direct—because local government are the ones who understand local needs. And they're reliable—empowering cities and communities to plan cost-effective solutions.

That's why the direct, reliable Gas Tax Fund is a solid model to build on. Every year, it empowers communities to deliver thousands of infrastructure renewal projects—from roads and transit to water, waste and energy systems.

Its one shortcoming is its scale. Budget 2019 recognized this by doubling this year's transfer, to move more projects forward.

It's time to build on what's working—by permanently growing the GTF transfer. As this report clearly demonstrates, the GTF is the most reliable and cost-effective step the next federal government can take to build better lives.

Endnotes

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