Foundations for Prosperity

Creating a Sustainable Municipal-Provincial Partnership to Meet the Infrastructure Challenge of Alberta's 2^{nd} Century

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CanadaWest FOUNDATION

MINISTER'S PROVINCIAL-MUNICIPAL COUNCIL
on Roles, Responsibilities, and Resources in the 21st Century

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Executive Summary

Foundations for Prosperity: Creating a Sustainable Municipal-Provincial Partnership to Meet the Infrastructure Challenge of Alberta's 2nd Century rests on three basic assertions:

- Community infrastructure provides the essential foundation for economic prosperity and quality of life;
- As substantial infrastructure debts and deficits illustrate so powerfully, the current funding arrangements for municipal infrastructure are inadequate; and
- This is a problem that can be fixed in a sustainable way.

Given these assertions, what are the steps forward to a sustainable solution? The recommendations in *Foundations for Prosperity* begin with recognizing the problem in principle, move to a more detailed operational definition of the problem, and then to a set of tools with which a sustainable solution can be built. More specifically, the Canada West Foundation recommends that:

- Albertans and their governments commit to eliminating the municipal infrastructure debt and its causes by 2015.
- An Alberta Municipal Infrastructure Council be established to focus and drive this commitment.
- By June 2005, the Alberta Municipal Infrastructure Council identify the optimal mix of infrastructure funding instruments drawn from three options: 1) a new set of tax tools for municipal governments; 2) a legislated framework for provincial revenue sharing with municipal governments; and 3) a phased provincial withdrawal from the education property tax.
- The Government of Alberta, in partnership with municipal governments, take the lead in establishing the principles and mechanisms for the Government of Canada's potential engagement in municipal infrastructure funding.
- The new funding instruments be given legislative effect by December 2005.

Although these recommendations are largely financial in character, they also lay the foundation for *a new governance partnership* that will better equip municipalities for the challenges they will face in Alberta's second century.

The recommendations have been framed in the context of competing demands on the Government of Alberta's enhanced fiscal capacity. It is important to stress, therefore, that creating a sustainable funding solution for municipal infrastructure should not fall on the shoulders of any one government; Albertans need a *balanced* and *comprehensive* strategy that includes the municipal, provincial and federal governments. At the same time, *Foundations for Prosperity* is unapologetic in asserting the importance of meeting the challenge of municipal infrastructure debt – healthy communities are essential if other provincial goals are to be achieved. In this critically important sense, effective action to create a sustainable municipal infrastructure partnership strengthens the very heart of the *Alberta Advantage.*

SETTING THE STAGE

In 1993, the Province of Alberta faced a major debt problem. Years of deficit spending had generated a substantial provincial debt that was undermining Alberta's competitive advantage. The Alberta government therefore initiated an aggressive debt elimination strategy, first by ending deficit spending and then by systematically paying off the debt. As a result, Alberta is now debt-free, the only province to be so. This enviable position opens the door for new and innovative opportunities as Albertans prepare to enter their province's second century in 2005.

One of those opportunities relates to community infrastructure, which provides the essential foundation for economic prosperity and quality of life. Although Alberta's provincial debt has been eliminated, municipal infrastructure debt remains. Municipal infrastructure spending has met neither the ongoing need for maintenance and replacement, nor the unrelenting pressure from vigorous economic and demographic growth. As a consequence, annual infrastructure deficits have accumulated in a large infrastructure debt. Like the provincial debt that Albertans began to tackle in 1993, municipal infrastructure debt weakens Alberta's competitive advantage by constraining economic productivity and quality of life.

> **"Although the negative impacts of a deficient infrastructure are only beginning to mount – and become visible to Canadians on a day-to-day basis – we believe that an ongoing neglect of the nation's stock of public capital represents one of the greatest risks to the country's overall quality of life. Notably, with the state of a region's infrastructure weighing more heavily on location decisions of highly mobile businesses and individuals, a deteriorating capital stock will increasingly cut into gains in productivity and living standards."**
>
> *Mind the Gap,*
> *TD Economics Special Report,*
> *May 20, 2004.*

Fortunately, Albertans now have the opportunity and capacity to address this problem. The very success of the provincial debt elimination strategy allows Albertans to turn to the challenge of municipal infrastructure debt, and the timing could not be better. Alberta's debt-free status, promising signs of federal government support for municipal infrastructure financing, and the upcoming provincial Centennial all favour bold steps to ensure that Alberta communities are national, indeed international leaders as places to live, work, visit and invest. In short, a sustainable solution is within reach through an aggressive strategy that methodically reduces the municipal infrastructure debt and puts into place systematic changes to guarantee that it does not return.

This opportunity also gives Albertans the chance to redesign community governance for the challenges of the 21st century, as the steps to address municipal infrastructure debt are necessarily steps towards a new governance partnership that recognizes communities as the foundations upon which we build individual and provincial success – even international success begins at home. A partnership model recognizes that while municipal governments are the primary means by which Albertans shape their communities, municipal governments are shaped in turn by provincial legislation determining their roles, responsibilities, and resources. Therefore to ensure healthy, vital, and sustainable communities, Albertans need a new provincial-municipal partnership reflecting the modern roles of municipal governments and the interdependent relationships in which those governments exist.

> **The Government of Alberta is committed to redesigning its relationship with municipalities. The Government's 20 year strategic plan, *Today's Opportunities, Tomorrow's Promise,* states that "strong municipalities are an essential part of a strong Alberta," and identifies "working with municipal governments to support strong, viable, safe and secure communities" as one of its key strategies. The plan also states that "Alberta in 2025 will be a place where municipalities and the provincial government work in fair partnership to serve their constituents." These are important goals – so important that Albertans should immediately begin work on implementation.**

All of this leads to the conclusion that tinkering with the status quo will not suffice; there is a need for bolder municipal and provincial leadership. By acting now to create a sustainable municipal infrastructure partnership, Albertans can enhance both quality of life and economic prosperity. Moreover, Alberta can seize national leadership by creating a partnership model for Canadians across the country as they address the increasingly complex challenges facing local communities. The recommendations in *Foundations for Prosperity* offer a roadmap for seizing these opportunities.

Of course, the fact that we *can* act now does not necessarily mean that we *should* act now, for there are competing demands on the Government of Alberta's enhanced fiscal capacity. It is important to stress, therefore, that the responsibility for creating a sustainable funding solution for municipal infrastructure should not fall on the shoulders of any one government; Albertans need a *balanced* and *comprehensive* strategy that includes the municipal, provincial and federal governments. At the same time, *Foundations for Prosperity* is unapologetic in asserting the importance of meeting the increasingly pressing challenge of municipal infrastructure debt – healthy communities are essential if other provincial goals are to be achieved. In this critically important sense, effective action to create a sustainable municipal infrastructure partnership strengthens the very heart of the *Alberta Advantage.*

UNDERSTANDING MUNICIPAL INFRASTRUCTURE DEBT

Municipal infrastructure touches virtually every aspect of daily life in large urban centers, smaller cities, towns and the province's counties and municipal districts; it has a huge impact on our quality of life and economic prosperity. Lately, however, the infrastructure foundations of local communities have come under increasing strain. Local government capital spending has been on a downward trend *(see Figure 1).* Municipalities routinely run infrastructure deficits (annual shortfalls in funding for essential infrastructure projects), and the result of annual deficits is a large and growing infrastructure debt (the accumulated backlog with respect to both new infrastructure and the maintenance, rehabilitation or replacement of existing infrastructure).

This points in turn to a critically important distinction between conventional debt and infrastructure debt. Whereas the provincial debt arose because the Alberta government spent *more* than it could afford on operating expenses, the municipal infrastructure debt has arisen because governments have spent *less* than they need to on infrastructure. The impact of conventional debt can be measured by the interest charges and debt repayment costs; the impact of infrastructure debt comes through diminished quality of life and economic prosperity. As Konrad Siu, Senior Infrastructure Officer for the City of Edmonton notes in this respect, infrastructure should be seen as an investment, not an expenditure.

FIGURE 1: Alberta Local Government Capital Flows
(1961-2002)

CHART 1: Local Capital Flows in Alberta as a % of Total Local Revenues

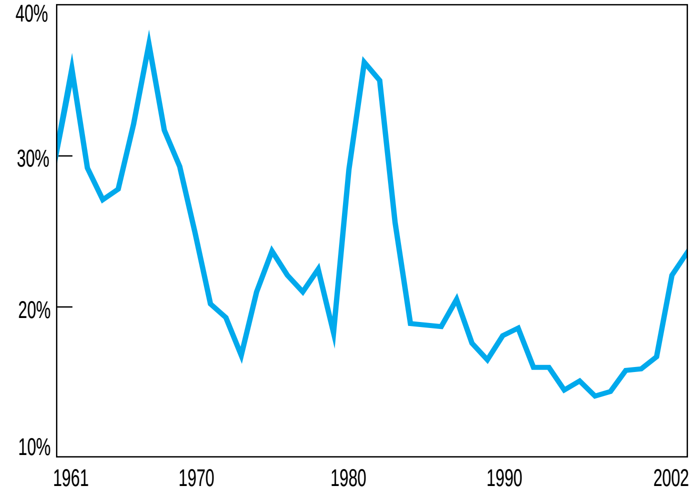


CHART 2: Local Capital Flows in Alberta as a % of Albertans' Incomes

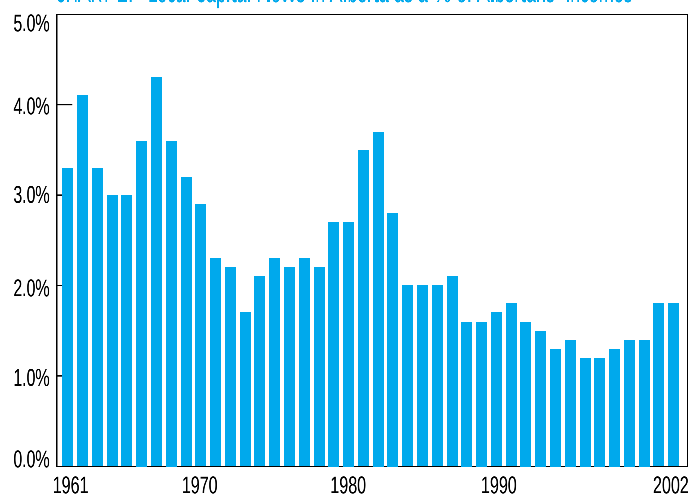
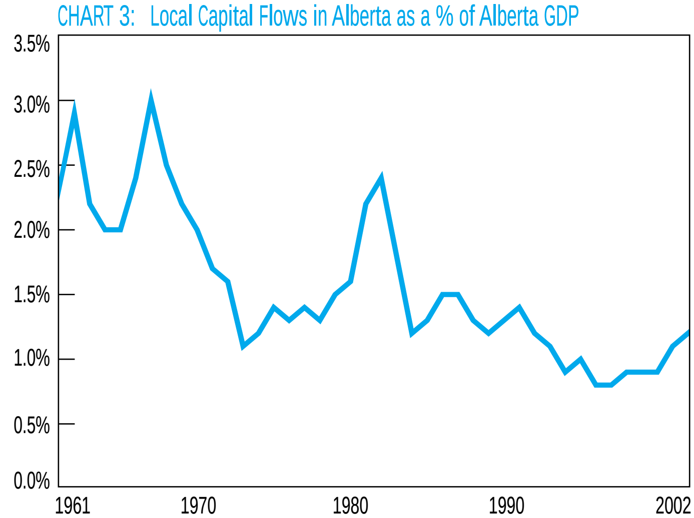


CHART 3: Local Capital Flows in Alberta as a % of Alberta GDP



SOURCE: Derived by CWF from Statistics Canada's Provincial Economic Accounts Cat. Nos. 13-21-3S (1961-1986), 13-213 Annual (1981-1991), 13-213 PPB (2002 Preliminary Estimates) and the Economic Observer.

The term "infrastructure" lacks a precise definition. When used broadly it can include transportation (e.g., roadways, bridges, pedestrian walkways and public transit), security and protection (e.g., fire, police, and emergency medical services), community resources (e.g., parks, recreational opportunities and cultural amenities); general government (e.g., civic buildings, information technology, vehicle fleets), utilities (e.g., water supply and distribution, sewage collection and treatment, solid waste management, storm drains and flood control), and environmental protection. In the discussion to follow, infrastructure will be used only to refer to the hard physical assets of municipal governments such as roads, bridges, mass transit systems, utilities, and recreational facilities.

The exact size of Alberta's municipal infrastructure debt is difficult to determine. Some analyses focus on national rather than provincial infrastructure debt figures. For example, in 2002 the Canadian Society of Civil Engineers pegged Canada's total local infrastructure debt at $57 billion, and predicted that, should immediate remedial action not take place, this debt will grow to $110 billion by 2027. If Alberta, with 10% of the national population, has 10% of the national infrastructure debt, the province would have a $5.7 billion challenge on its hands, one that will grow to $11 billion if not promptly addressed. Debt estimates specific to Alberta include the following:

- The City of Edmonton estimates a $1.55 billion shortfall in capital and infrastructure funding over the next five years. The City estimates that it should be spending about $360 million a year to replace or rehabilitate existing infrastructure, but will be able to afford only $165 million, for an annual shortfall of at least $195 million over and above spending needed to accommodate new growth. *(A Capital Question, p. 15).*

- The City of Calgary anticipates an upcoming five year infrastructure shortfall of at least $1.12 billion coming from unmet needs for roads, bridges, walks, curbs, traffic controls and transit. *(A Capital Question, p. 17).*

- A recent Alberta Recreation and Parks Association survey of the province's recreational facilities estimated that by 2005, over 75% of the major recreational facilities in the province would be in the last half of their functional life expectancy; the upgrading cost was estimated to be $270 million, with a replacement cost estimated at close to $1 billion. *(The Community Recreation Infrastructure Report, June 2002).*

These estimates are only parts, albeit important parts, of a larger picture. Nonetheless, while the exact parameters of the municipal infrastructure debt may be open to debate, *there is a very broad consensus that the debt exists, that it is substantial, and that it poses a threat to the quality of life within and the economic prosperity of Alberta's communities.* In short, no one questions that a problem exists, and that it needs to be addressed.

Moreover, there is also a strong consensus on the drivers of infrastructure debt *(see Figure 2).* Alberta faces growing pressure on the demand side of the financial equation. Population growth and the resultant need for new infrastructure, existing infrastructure that requires maintenance and repair, and rising standards for such things as environmental protection all increase the need for infrastructure spending. At the same time, fiscal constraints across all orders of government, uneven economic growth, competing budget priorities, and electoral resistance to capital debt financing have all restricted infrastructure investment just as the need for such investment has grown. A substantial funding gap has emerged.

Infrastructure spending, of course, is taking place. The City of Edmonton, for example, estimates that 30% of its entire budget goes to infrastructure. However, spending levels are not sufficient. In *Mind the Gap,* the TD Bank Financial Group estimates that the current shortfall "stands in the order of 6-10 times annual investment flows."

> **"It is no secret that throughout the 1990s Canada's cities have undergone a financial crunch in the form of reduced operating grants, inconsistent and unpredictable capital funding for investments in infrastructure, and the offloading of certain public services as the federal and provincial governments sought to end their own budget deficits and stem the growth in public debt."**
>
> *Canada West Foundation, Dollars and Sense, 2001.*

On top of this compounded problem of growing demand and revenue constraints rests the complex issue of revenue tools. Municipal governments have a restricted and relatively undiversified set of tax tools and revenue sources. Their primary reliance on the property tax is a constraint on meeting the challenges of growth. Municipal governments, it has been argued, need a broader, more predictable and more sustainable revenue base. They also need financial management tools that more successfully capture life-cycle costing – the total cost of operating, maintaining, rehabilitating and replacing an infrastructure asset – and that recognize the unique role played by capital.

FIGURE 2: Examples of Infrastructure Deficit Drivers

CHART 1: Alberta Population Growth by Various Sized Centres (1996-2001)

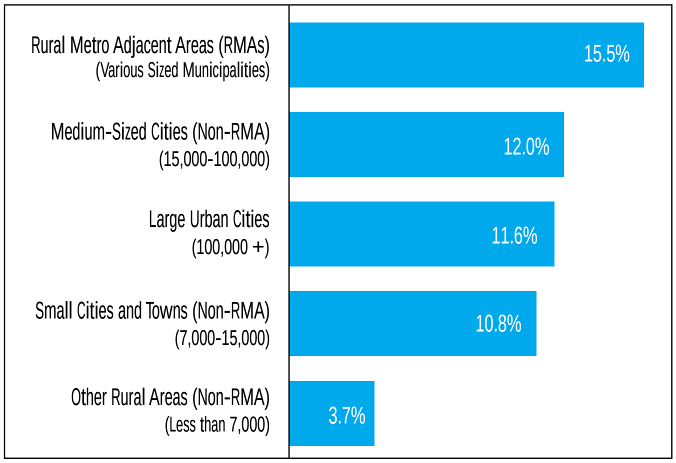


CHART 2: Age of Public Infrastructure in Canada (All Governments)

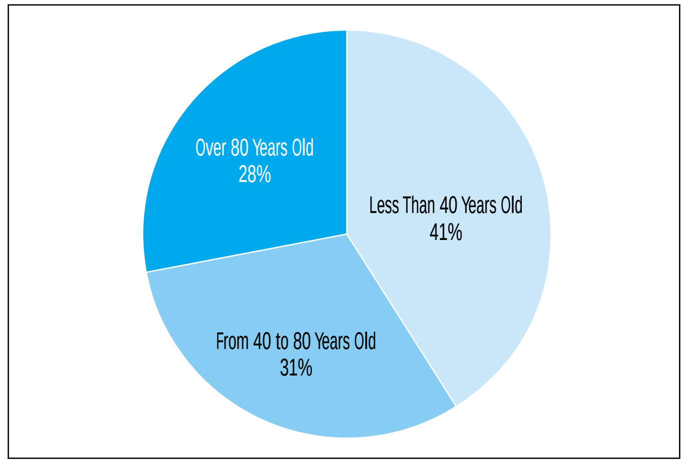


CHART 3: % of Capital Expenditures Financed by Debt (Calgary)

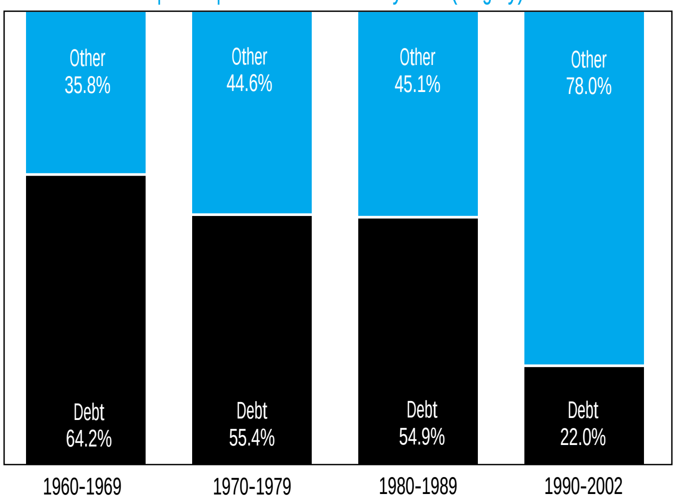


CHART 4: % of Capital Expenditures Financed by Debt (Edmonton)

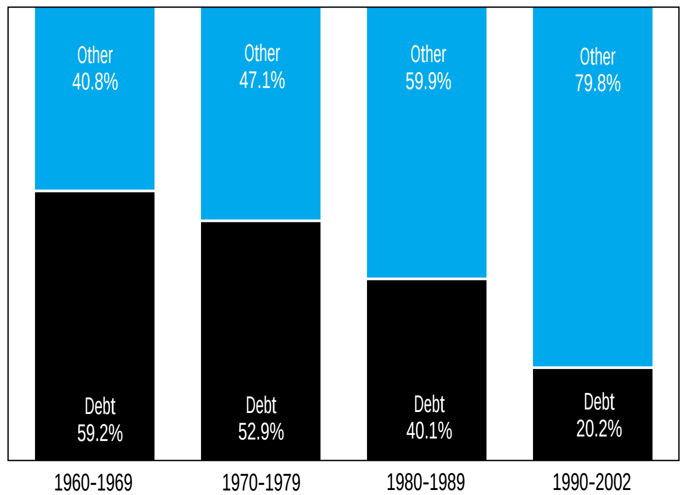


CHART 5: 2000 Tax Profile (Calgary)

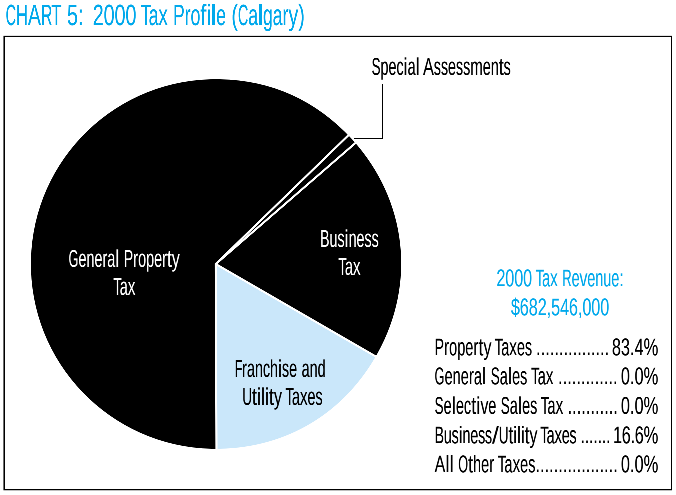
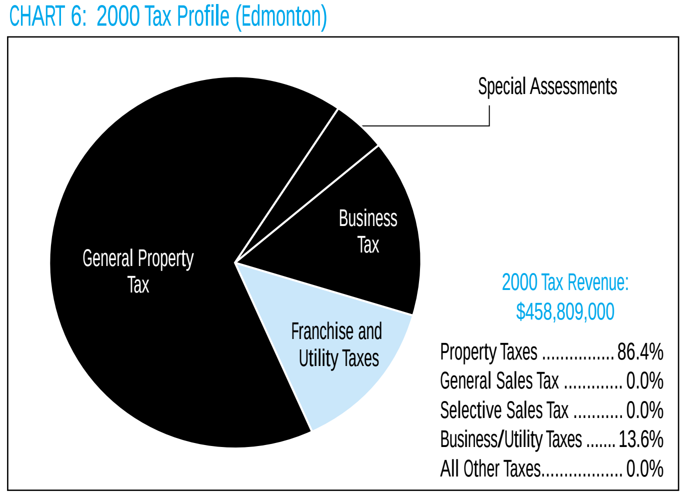


CHART 6: 2000 Tax Profile (Edmonton)



SOURCE: Derived by CWF from Statistics Canada census reports, Canadian Society of Civil Engineers, and the Annual Reports of Calgary and Edmonton (1960-2002). Rural Metro Adjacent Areas (RMAs) are urban and rural municipalities that are directly adjacent to a large urban core or within a short commuting distance from it, but not part of the urban core itself. All municipal districts and rural municipalities that are adjacent to the urban core of a CMA, along with all cities, towns and villages within these rural municipalities, are classified as RMA.

In short, municipal governments and their communities are not well-situated to meet their growing challenges. As Casey Vander Ploeg writes in *No Time to Be Timid*, "Approaches that fail to address the primary drivers of the problem in a meaningful way provide only short-term relief. *What is needed are sustainable approaches and alternatives to resolve the matter in the long term"* (emphasis added). The sustainable approaches he proposes are presented in *Figure 3.*

FIGURE 3: Addressing the Infrastructure Deficit Drivers

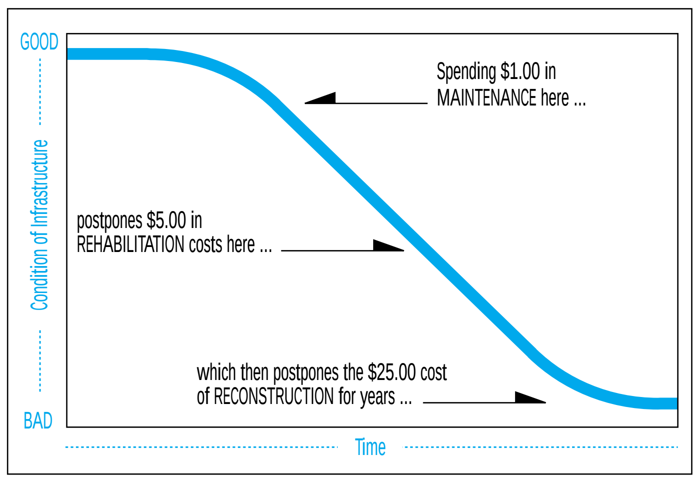
DRIVERS	GOALS TO BE PURSUED
INFRASTRUCTURE DEMAND:	
Population Growth	Change incentives. Urban density. User pay.
Aging Infrastructure	Proper maintenance, rehabilitation, replacement.
Rising Standards	Emphasize functionality over other factors.
Lack of Pricing	Activity-based accounting. Marginal cost pricing.
INSUFFICIENT REVENUES:	
Fiscal Restraint	Long-term planning. Change attitudes to capital.
Competing Priorities	Reform other services to free up funds.
Property Tax	Tax diversity to compensate for current incentives.
Attitudes to Debt	Combine "pay-as-you-go" with "smart debt."
UNDERSTANDING INFRASTRUCTURE:	
Life-Cycle Costing	Employ strategic asset management strategies.
Accounting	Appreciate the unique role played by capital.

SOURCE: Vander Ploeg, Casey. 2004. *No Time to be Timid.* Canada West Foundation.

A number of long-term costs result from failing to invest adequately in municipal infrastructure. If infrastructure spending is deferred, municipalities will encounter higher capital costs in the future as rehabilitation and replacement are significantly more expensive than is regular maintenance *(see Figure 4).* These costs are borne by municipalities (and taxpayers due to higher tax burdens), and by businesses through lost productivity. There are also significant costs for individuals in terms of health and safety. For example, investments in municipal infrastructure improve public sanitation and road safety – and thus limit preventable health care costs. The conclusion is inescapable: Alberta's municipal infrastructure debt and its associated costs have grown to the point where the problem must be tackled.

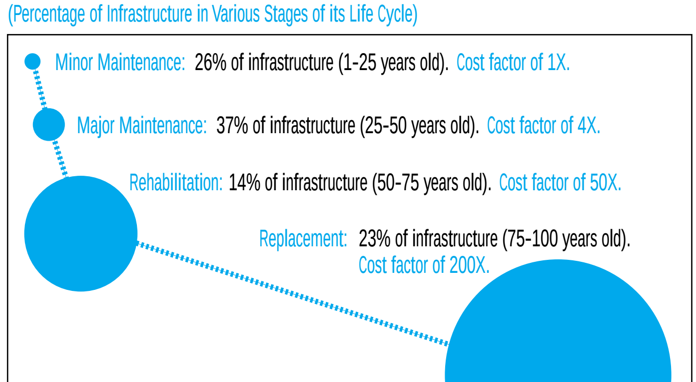
FIGURE 4: The Compounding Costs of Infrastructure Debt

CHART 1: DeSitter's Laws of Fives



SOURCE: Derived by CWF from *Financing Infrastructure Preservation: Challenges and Opportunities*, City of Winnipeg Public Works Department, April 24, 2001, and Vanier 2000a.

CHART 2: Water and Sewer Infrastructure in Hamilton
(Percentage of Infrastructure in Various Stages of its Life Cycle)



SOURCE: Derived by Canada West Foundation from the *Regional Municipality of Hamilton-Wentworth, Infrastructure Asset Management Strategy Program*, R.V. Anderson Associates Ltd., October 2000.

As the April 2002 report of the TD Bank Financial Group illustrates, the problem for large cities is often given particular emphasis in discussions of infrastructure debt:

> **"The bottom line is that all Canadians are stakeholders in our nation's future. And, we must all recognize that cities will be at the forefront of Canada's march into the 21st century. Without robust and vibrant cities, there is simply no hope for achieving the objective of beating the U.S. standard of living within 15 years."**

However, infrastructure problems are not restricted to large urban centres, or to particular communities. The *Alberta Association of Municipal Districts and Counties (AAMD&C)*, for example, reports that rural municipalities are responsible for 135,000 km or 85% of all municipal roads and 9,452 or 95% of municipal bridges in Alberta, and the Canada West Foundation report, *The Burgeoning Fringe*, notes growing infrastructure costs in rural metro-adjacent areas. The problem is a comprehensive one that calls for a comprehensive solution.

AN ACTION PLAN FOR MOVING FORWARD

> **"...municipal governments are requesting additional fiscal support to build infrastructure and social capital that will help deal with rapid growth or attract new residents and economic development. This challenge goes to the heart of the mandate of the Committee. *Alberta cannot continue to be a credible leading voice within Canada if we fail to find solutions that will make our communities more vibrant and economically sustainable* (emphasis added) ... The Committee recommends that the Government of Alberta seize the opportunity to be a national leader by working with municipalities to find solutions to issues surrounding municipal funding and fiscal flexibility."**
>
> *Report of the MLA Committee on Strengthening Alberta's Role in Confederation, June 2004, pp. 51-52.*

An effective action plan to eliminate Alberta's municipal infrastructure debt must engage all governments, begin with recognizing the problem in principle, move to a more detailed operational definition of the problem, and then to a set of tools with which a sustainable solution can be built.

RECOMMENDATION 1: *Albertans and their governments should commit to eliminating the municipal infrastructure debt and its causes by 2015.*

In the face of competing policy priorities, including health care and education, it may be difficult for Albertans to understand why tackling municipal infrastructure debt is so important to their future prosperity and quality of life. After all, we have done relatively well despite years of under-funding municipal infrastructure – why do we suddenly need to address this issue now? The answer to this critically important question is three-fold:

- Municipal infrastructure debt – which includes debt with respect to the infrastructure we see on a daily basis, such as roads and public transit, and the infrastructure that we do not see, such as water mains and sewers – has grown to the point that it simply must be addressed. As the Alberta government concluded in terms of the provincial debt in 1993, there comes a time when one must stop contributing to the problem and begin contributing to the solution.

- There are long-term costs should Alberta fail to address municipal infrastructure debt. The vitality of our communities, indeed the *Alberta Advantage* itself, depends on meeting infrastructure needs.

- Infrastructure provides the foundation upon which we can build success in other areas. Rather than competing with health and education spending, infrastructure spending is an essential complement.

This line of reasoning must be communicated to Albertans, for we cannot assume an existing public consensus on the infrastructure problem or its urgency. An essential part of this communications strategy is for the provincial and municipal governments to explicitly commit to eliminating the municipal infrastructure debt and its causes by 2015. The advantages of an aggressive timeline are illustrated by Alberta's experience with the provincial debt in the 1990s. A time-specific goal for debt elimination promotes singularity of purpose, brings all parties together to address a common goal, and allows for public accountability and pride. A 10 year strategy provides predictability while also reducing competition with other government priorities.

> **Eliminating the existing infrastructure debt – infrastructure that is unbuilt or unrepaired – should not be confused with the use of debt financing for new infrastructure projects. Debt financing is an essential part of the municipal tool box. As Casey Vander Ploeg points out in *Dollars and Sense*, "Total 'pay-as-you-go' funding for all tax-supported capital expenditures puts the cost on today's generation for benefits that flow well into the future. Complete debt financing gives the generation building the capital stock a 'free ride.' The issue is very much one of finding the right balance."**

And how might this government commitment to eliminate the municipal infrastructure debt and its causes be given effect? By moving expeditiously to implement the recommendations that follow below.

RECOMMENDATION 2: *An Alberta Municipal Infrastructure Council should be established to focus and drive the commitment to eliminate the municipal infrastructure debt.*

If the 2015 debt elimination target is to be met, it is essential to have a detailed work plan and organizational accountability for that plan. It is recommended, therefore, that the Government of Alberta and its municipal partners establish the *Alberta Municipal Infrastructure Council* with the responsibility to:

- Reach consensus on the size of the existing municipal infrastructure shortfall (both accumulated debt and annual deficits), which also entails reaching a consensus on what to include under the infrastructure label;
- Establish the net revenue increase needed to eliminate the existing municipal infrastructure debt and annual infrastructure deficits; and
- Set benchmarks for debt reduction.

The Council, which would include provincial and municipal representation, would *not* be a forum for making community-based infrastructure decisions. The Council's mandate would be to set the overall framework for the debt elimination strategy, and *not to micromanage infrastructure decision-making within communities.*

The Council's first task would be to determine the size of the debt and deficit shortfalls across the full range of municipal governments in Alberta. Now admittedly, there is no magic here as estimates will vary for legitimate reasons. Nevertheless, it is essential to scope out the problem before moving to solutions. In the event that the Council has difficulty in reaching a consensus, it should seek advice from a committee of experts, jointly selected by the Council membership. In the final analysis, however, a political determination must be made as to the magnitude of the municipal infrastructure problem, and in this respect a good deal of work has already been completed.

The Council's second task would be to determine the amount of additional funding needed to cover both the existing debt and annual infrastructure deficits. (It makes no sense to pay down the existing debt if at the same time municipal governments are building up new debt; certainly the provincial experience shows that bringing deficits under control is the first step toward debt elimination.) The answer will come from the consensus on the size of the existing infrastructure debt, the annual infrastructure deficits faced by municipal governments, and the desired pace of debt elimination. The amount of additional infrastructure funding needed on an annual basis should be fixed at the amount needed to pay down the existing infrastructure debt, prorated over the next decade, plus the amount needed to eliminate current infrastructure deficits.

Background work for the Minister's Provincial-Municipal Council on Roles, Responsibilities, and Resources called for an additional $800 million annually in infrastructure spending over ten years, with $350 million earmarked for deferred rehabilitation and maintenance, and $450 million for deferred new capital spending. On an annual basis, this would be equivalent to less than 4% of the provincial budget.

Beyond resolving these difficult but essential technical issues, the Council would provide enhanced accountability by clearly identifying benchmarks for debt elimination. Given the large-scale challenge of addressing infrastructure debt, and given the multi-party nature of the effort (unlike eliminating the provincial debt, which was solely the responsibility of the Alberta government), it is important to establish a mechanism to ensure accountability and to track progress on meeting debt elimination targets. The Council would report back to all stakeholders – Albertans, the provincial legislature and municipal councils – on the allocation of funds and overall progress toward infrastructure debt elimination. Strengthened accountability is particularly important if the debt elimination strategy includes revenue sharing (discussed below), which can create problems of accountability when one government spends money raised by another.

It is important to note that it may not be necessary to create an entirely new body to handle these tasks. An existing body, such as the Minister's Provincial-Municipal Council on Roles, Responsibilities and Resources in the 21st Century could be charged with these new responsibilities. The essential concern lies with the tasks themselves, not with the organizational form through which they are addressed, and with the adequate representation of municipal governments. However, a new Council would have a higher public profile, and thus may be more effective in communicating the importance of the infrastructure challenge. It may also be more effective in terms of public accountability for the infrastructure strategy. Nonetheless, the selection of the appropriate institutional body is less important than the mandate entrusted to that body.

RECOMMENDATION 3: *By June 2005, the Alberta Municipal Infrastructure Council should identify the optimal mix of infrastructure funding instruments drawn from three options: 1) a new set of tax tools for municipal governments; 2) a legislated framework for provincial revenue sharing with municipal governments; and 3) a phased provincial withdrawal from the education property tax.*

Once there is agreement on the size of the infrastructure problem and the timelines within which it will be addressed, the discussion needs to turn to potential solutions. The essential question is this: *how can we best distribute the cost of eliminating the municipal infrastructure debt and its causes across available revenue sources?*

Here there are a number of options including new municipal tax tools, provincial revenue sharing with municipal governments, and provincial government withdrawal from the education property tax. The optimal solution should:

- Be sustainable over time by addressing not only the existing debt but also its causes, thus ensuring that municipal infrastructure deficits and debts do not reoccur in the future;
- Be appropriate to the scale of the problem;
- Spread the load and responsibility across governments; and
- Maximize public accountability.

Given this principled framework, the optimal solution may well be a mix of three basic funding strategies.

1. New Municipal Tax Tools

If municipal governments are to shoulder their share in eliminating the infrastructure debt, and if they are to avoid infrastructure deficits in the future, they will require tax tools (revenue sources) that go beyond the property tax and user fees. Such tools could also serve a more general purpose by ensuring that municipalities have greater self-reliance, that they have greater autonomous financial capacity to respond creatively to the needs and aspirations of their electorates.

Options to consider include municipal taxes on hotel occupancy, vehicle registrations, land transfers, parking stalls, fuel consumption, and motor vehicle rentals; these are examples, and examples only. The *Municipal Government Act* would have to be amended to allow municipalities to employ such new tax tools, should they choose to do so, thereby providing a flexible sphere of taxation authority analogous to the existing sphere of municipal responsibilities. Amendment would give municipal governments greater capacity to raise own-source revenues through a larger and more diversified basket of tax tools; community control and electoral accountability would both be enhanced.

A set of new tax tools would also provide municipal governments with the opportunity to capture revenue from those, such as tourists and commuters, who currently use municipal services but do not contribute directly through property taxes. However, there are a number of important caveats to keep in mind. Not all of the tax tools would be practical, or even appropriate, for all municipalities, although tax-pooling agreements could offset many of the problems associated with the small size of some municipalities. Of particular concern is the limited utility of some of the potential new tax tools, such as rental car and hotel occupancy taxes, for small rural municipalities. Finally, it should be stressed that even the most expansive set of new tax tools will not generate sufficient revenue to eliminate the existing municipal infrastructure debt or avoid infrastructure deficits in the future. New municipal tax tools should likely be *part* of the solution to the challenge of municipal infrastructure debt, but they will not be *the* solution.

2. Provincial Revenue Sharing

If the partnership goal is to eliminate the municipal infrastructure debt and avoid infrastructure deficits in the future, new municipal tax tools will not take us as far as we need to go. There is also a need for additional provincial government funding that could come through a legislated revenue sharing framework, building conceptually on the existing provincial fuel tax rebates to Calgary and Edmonton.

The case for more comprehensive revenue sharing as part of the package to address the infrastructure debt rests on the marked difference in fiscal capacity between the provincial and municipal governments. The province has access to tax sources, such as the personal income tax, that are beyond the reach of municipal governments. Moreover, some of its major revenue streams (e.g., the provincial personal income tax) reflect economic growth immediately whereas municipalities rely primarily on property taxes that lag growth and respond erratically to swings in economic prosperity. Legislated revenue sharing would enable municipal governments to share both good and bad times with the Alberta government, and do so within a predictable framework.

A sustainable revenue sharing framework would need to be legislatively embedded, thus predictable over time, and pegged to – be benchmarked by – specific provincial tax sources. For example, the amount of revenue sharing could be set at a percentage of the provincial personal income tax (a 10% equivalent transfer would amount to approximately $500 million annually), the provincial fuel tax (an equivalent transfer of an additional 1¢ of the existing tax, or a universally applied 1¢ increase to the existing tax, would amount to approximately $60 million annually), or provincial gaming revenues (a transfer of 10% would amount to approximately $110 million annually). Revenue sharing could be phased in provided that the timetable was legislatively specified. The Alberta Municipal Infrastructure Council (or its functional equivalent) should report to all stakeholders on how the shared revenues are being used to pay down the infrastructure debt and eliminate infrastructure deficits. However, revenue sharing should not be framed as a conditional grant – municipalities should be solely responsible to select the infrastructure projects (new projects or maintenance of existing infrastructure) in which they choose to invest. The Council's role should be to report on debt reduction benchmarks, not to police municipal government decision-making.

Manitoba, under its Provincial Municipal Tax Sharing Act, allocates 2.2% of provincial personal income tax revenues plus 1% of provincial corporate tax revenues to municipalities. In British Columbia, 11¢ per litre of the provincial fuel tax collected in the metropolitan Vancouver area is rebated to Translink, the Greater Vancouver Transportation Authority. In October, 2004, Ontario municipalities will begin to receive 1¢ of the provincial fuel tax, a portion scheduled to increase to 1.5¢ in 2005 and 2¢ in 2006. Manitoba and British Columbia both share gaming revenues with municipalities, whereas in Alberta a portion of gaming revenues flows through provincial grant programs to community organizations and/or non-profit groups rather than to municipal governments.

3. Provincial Withdrawal From the Education Property Tax

At present, residential and commercial property taxes provide the mainstay revenue source for municipal governments in Alberta, and for that matter across the country. It is appropriate to ask, therefore, whether property taxes could be increased in order to carry more of the infrastructure load. In this respect there is some evidence that residential property taxes have been in decline as a percentage of personal income, and thus it can be argued that some tax room exists. This room could be significantly increased if the Government of Alberta were to vacate property taxes, in full or in part.

The Alberta government currently collects about $1.4 billion annually from the provincial education property tax, approximately 5% of total provincial revenues. The withdrawal of the provincial government from the property tax has already been proposed in a private member's motion supported by the Alberta legislature in the spring session, 2004. Motion 501, as amended, reads:

> **"Be it resolved that the Legislative Assembly urge the government to phase out the education portion of property taxes over a 10-year period, gradually supplementing the loss from alternative sources thereby freeing up financial resources for municipalities to adequately provide required services."**
>
> *(Hansard, February 23, 2004).*

A full or even partial provincial withdrawal from the property tax would create more tax room for municipal governments to fund infrastructure and/or core municipal services. If they chose to occupy this tax room, or for that matter chose not to do so, municipal governments would be directly accountable to their local electorate. Provincial withdrawal would therefore clarify accountability, and municipalities would be able to innovate more with property tax assessment mechanisms.

For a number of reasons, however, this option should not be seen as a silver bullet for the elimination of municipal infrastructure debt. First, property tax increases are more difficult to achieve than are increases in provincial and federal tax revenues. For example, if the City of Calgary were to impose a 4.9% municipal property tax increase, or an additional $40.00 annually for the owner of a $200,000 home, this increase could only be obtained through an open and highly publicized adjustment of the property tax rate. If in the same year the same property owner were to receive a salary increase of 3%, or $1,800 on an annual salary of $60,000, he or she would pay an additional $587 in federal and provincial income tax. If half of the salary increase was spent, the additional GST revenue to the federal government would be $63.00. Therefore the provincial and federal governments combined would collect an additional $650 with no increase in the tax rate, and no debate in the Legislature or House of Commons, while the City of Calgary could face considerable backlash for its additional $40.00.

Second, a complete provincial withdrawal from the education property tax may face a constitutional challenge, and would almost certainly be opposed politically by separate school boards in the province. It may also be the case that a complete withdrawal, *if coupled with full occupancy of the resultant tax room by municipal governments,* would create more infrastructure funding that might be needed.

Third, and most importantly, this strategy would make municipal governments even more reliant on a narrow tax base, one that is not particularly sensitive in the short term to economic growth and is relatively unattractive for rural municipalities. Thus creating more property tax room for municipal governments should only be seen as part of a comprehensive and sustainable strategy to eliminate municipal infrastructure debt.

> **If revenue sharing is introduced, if municipal governments have access to new tax tools and have greater tax room with respect to the property tax, a corresponding withdrawal by the Government of Alberta from municipal capital grants would be appropriate. This would reduce conditionality, strengthen electoral accountability, and increase predictability. However, municipal capital and operating grants may continue to play a significant role for smaller municipalities where alternative revenue tools are less feasible, and for situations in which capital grants are designed to deal with spillovers and externalities.**

Determining the optimal balance among the three funding options discussed above is ultimately a political decision. The municipal and provincial governments must decide how much additional revenue is needed, and how that revenue might best be generated. This entails weighing the appropriate contributions from provincial and municipal taxpayers, and deciding which, if any, new funding mechanisms should be put in place. The proposed Alberta Municipal Infrastructure Council could provide the forum for such discussions.

For its part, the Canada West Foundation recommends a careful mix of all three options, with particular stress on new municipal tax tools and revenue sharing. Such a mix not only spreads the load but is likely to be sustainable over time.

RECOMMENDATION 4: *The Government of Alberta, in partnership with municipal governments, should take the lead in establishing the principles and mechanisms for the Government of Canada's potential engagement in municipal infrastructure funding.*

To this point, the focus of the report has been on what Alberta governments can do in partnership, without federal government engagement. However, it is clear that the Government of Canada must be taken into account in drafting a comprehensive debt elimination strategy.

Although potential federal funding should not distract us from creating a made-in-Alberta solution to municipal infrastructure debt, the federal government will become more actively engaged in municipal infrastructure issues even though the extent and modalities of its engagement are still far from clear. Moreover, given that the policy goals of all governments are achieved in large part through and within communities, federal program activity and funding decisions generally will inevitably have an impact on the health, vitality, and sustainability of Alberta communities.

It is important, therefore, that the Government of Alberta and its municipal partners work positively with the federal government. As such work is already actively underway, this recommendation is simply designed to provide additional impetus.

Federal funding, it must be stressed, should not be seen as a substitute for provincial and/or municipal action, particularly when we know little about how much federal funding will be available, when it will come on stream, and what conditions will be attached. It is also difficult to predict whether federal funding will be sustainable – federal government interest in the municipal infrastructure file may well wax and wane. Nonetheless, properly designed federal engagement could add valuable momentum to a go-forward municipal strategy in Alberta. At issue is how to structure the involvement of the federal government in a fashion that will best foster sustainable and prosperous communities.

The proposed Alberta Municipal Infrastructure Council (or its functional equivalent) could provide a useful mechanism for handling the federal connection. It could serve as the conduit for federal funding, thus providing accountability and a mechanism for coordinating federal, provincial and municipal infrastructure spending. It could also serve as a vehicle for promoting other forms of revenue sharing with the federal government that might go beyond the federal fuel tax.

Hopefully, the extent and parameters of federal government funding will be established by the time that the Alberta Municipal Infrastructure Council (or its functional equivalent) decides on the appropriate mix of Alberta-based funding options. Federal engagement will have some impact in determining the size of the problem those options will have to address.

RECOMMENDATION 5:: *The new funding instruments should be given legislative effect by December 2005.*

Although the Alberta Municipal Infrastructure Council (or an analogous body) can recommend a sustainable funding solution, it cannot give legal effect to its recommendations. The creation of new municipal tax tools, for example, requires amendments to the *Municipal Government Act,* and the implementation of those tools requires action by municipal councils. Revenue sharing and a partial provincial withdrawal from the education property tax require action by the Legislative Assembly.

It is essential to move expeditiously from the deliberations of the Council to legislative implementation. The slower we move, the larger the debt problem becomes as deficits continue to pile up. It is recommended, therefore, that December 2005 be the target for legislative implementation.

CONCLUSIONS

The recommendations outlined above constitute a measured and balanced approach to the problem of municipal infrastructure debt. The steps are straightforward:

- First, explicitly acknowledge the problem of municipal infrastructure debt and its negative impact on Alberta communities.
- Second, establish a consensus on the amount of the financial shortfall, taking into account both the existing debt and recurring deficits in infrastructure spending.
- Third, determine how the response to this shortfall should be distributed across a number of options – new municipal tax tools, revenue sharing with the provincial government, greater municipal occupancy of the property tax, and federal funding.
- Fourth, give legislative effect to any new funding mechanisms that are needed.

Given sufficient political will, there is no reason why a sustainable municipal infrastructure partnership could not be in place by the time Alberta wraps up its Centennial in December 2005.

> **"Spending levels for most of the large western Canadian cities have not increased substantially relative to population and inflation, and in fact, have actually fallen for most of the cities. This, coupled with the fact that westerners themselves remain very supportive of both the purposes and services behind municipal expenditures, indicates that efforts to ensure the fiscal sustainability of our cities need to be redoubled, for without it, we could well fall behind in maintaining and building the West's urban spaces."**
> *Canada West Foundation, Big Spenders?*

The recommendations in *Foundations for Prosperity* are designed to take Albertans toward a new community vision. They provide a framework for addressing the infrastructure debt, one that recognizes the importance of communities and their governments for Alberta's economic prosperity, quality of life and international competitiveness. They provide 21st century tools to meet 21st century challenges and opportunities. The way ahead is clear, the means are within our reach, and the time to act is now. ■

QUESTIONS and ANSWERS

The recommendations in *Foundations for Prosperity* are bold in scope, going well beyond modest adjustments to current practice. As such, they are bound to raise questions for Albertans trying to think through the future of their families, communities and province. However, the answers to these questions should encourage us to act, and act quickly.

Will the recommendations hurt the Alberta Advantage?

No. Although the *Alberta Advantage* is identified primarily with low taxes, it also rests on Alberta's economic opportunities, resources, and natural environment – in sum, on the quality of life Albertans enjoy. That quality of life plays out within our communities, and thus the Alberta government's 20 year strategic plan projects "making Alberta the best place to live, work and visit." This goal, however, can only be accomplished if municipal governments have the capacity to create and maintain attractive communities, which in turn requires eliminating the municipal infrastructure debt and its causes. Alberta communities will want to retain the competitive advantage of low taxes, but this advantage will mean little if Albertans lack a high and sustainable quality of community life. The recommendations in this report are designed to reinforce, not dilute, the *Alberta Advantage.*

Will there be a massive revenue shift from the provincial government to municipalities?

No. The existing annual municipal infrastructure deficit likely amounts to less than 5% of the provincial budget, with some estimates placing it closer to 3%. Given that the options to address this shortfall include federal funding and new municipal tax tools along with provincial revenue sharing, Alberta's fiscal environment will not be radically transformed.

Will the recommendations mean less money for health care and education?

No. The argument is not that municipal infrastructure needs should trump those of health and education. To the contrary, vital and sustainable communities are a precondition for meeting other complementary objectives. If we don't move on all fronts, it will be difficult to make sufficient headway on any one. For example, we hear a great deal about the community determinants of health – distressed communities are associated with a decline in individual health status and consequential costs to the health care system. Another example: poorly designed roads, or road systems used beyond their optimal capacity, are associated with motor vehicle accidents and preventable health care costs. Infrastructure investment is a necessary element in the pursuit of other goals.

Will the recommendations help big cities at the expense of smaller communities?

No. The only area where big cities would appear to have an advantage comes from new tax tools that might have little applicability for smaller municipalities. It is important, therefore, that provincial enabling legislation address potential inequities in the distribution of tax capacity across communities of different size and circumstance.

Would the creation of new tax tools and revenue sharing with the provincial government prompt a dramatic escalation in municipal spending?

No. Some increase in municipal spending will occur, for the very existence of infrastructure debt implies the need for additional capital expenditures. However, municipal governments are relatively constrained in their expenditures – note, for example, the intense debate that accompanies any attempt to increase the property tax. Moreover, there is little reason to believe that the same citizens will impose fewer expenditure constraints on municipal governments than they do on the provincial government.

Should the Alberta government just use anticipated surpluses to address the infrastructure debt?

Not directly. The Government of Alberta is now debt free, and if provincial revenues are sustained as debt repayment and servicing charges disappear, significant surpluses will be generated. This prospect, buoyed even more by high energy prices, has led understandably to the call from health care providers, schools, universities, and municipal governments to "share the surplus." Yet if a municipal infrastructure debt elimination strategy is to be sustainable over time, it cannot be based on highly variable and unpredictable surpluses. Revenue sharing should be pegged to ongoing provincial revenue streams (e.g., a specified percentage of the provincial personal income tax). Surplus-based revenue sharing can address one-off infrastructure needs, but it is not sustainable.

Will the recommendations result in a net tax increase for Albertans?

Perhaps, but the increase would be modest. The existence of an infrastructure debt reflects a revenue shortfall that must be addressed. If more funding is not provided, the debt will not evaporate on its own and indeed will likely grow as infrastructure spending continues to be deferred. It would therefore be misleading to suggest that the debt can be eliminated without Alberta taxpayers at some point and in some form picking up the cost. Certainly introducing new revenue sources for municipal governments, such as a municipal fuel tax, would mean additional local taxes. However, it should also be noted that current municipal tax loads as a percentage of GDP or personal income are significantly lower than they were a decade or two ago, and thus a modest increase might best be seen as a return to historical levels.

In a 2004 survey of 800 Albertans conducted by the Canada West Foundation, respondents were asked the following question: "Municipal governments typically provide services like police, fire, water treatment, transit, recreation, and building and maintaining roads and other local infrastructure. If your local government were faced with the choice of either increasing its revenues by raising taxes or decreasing expenditures by cutting services, which would you prefer?" By a margin of two to one, Albertans opted for raising taxes (60.8%) rather than cutting services (31.0%).

Will the recommendations increase the profile of municipal governments at the expense of the provincial government?

No. Neither the functions nor the budgetary scope of the provincial government will be significantly diminished. This is not a zero-sum game.

Would the proposed Alberta Municipal Infrastructure Council constitute another layer of government?

No. Governments already exist within an interdependent world. The Council is designed to strengthen accountability and communication, and not to replace the authority of municipal governments to set priorities or the authority of the provincial government to determine levels of support. The Council would not be another government. It is a means to bring greater oversight, coherence, and accountability to existing governments.

Should we wait to see what Ottawa does before acting provincially?

Absolutely not. Ottawa's community agenda will take time to evolve, and at this point we know very little about the amount, timing and conditionality of federal funding. Albertans should not wait to put their own provincial-municipal house in order. In addition, the more rapidly and creatively Albertans move within the province, the greater the leverage they will have on designing the federal-provincial-municipal relationship.

Is there a need to act now?

Absolutely. The planets are aligned – we know the problems, we have the capacity, we have an unprecedented level of federal government interest, and we have the opportunity for national leadership if we act sooner rather than waiting to join someone else's parade. We do not need more study before reaching agreement on a principled framework for moving forward.

Will the recommendations strengthen the communities within which Albertans live?

Yes. The recommendations are not about reshuffling the existing deck of responsibilities and resources. They are about new and better opportunities for Alberta citizens and their governments.

SOURCES

Much of the research base for this report comes from the Canada West Foundation's *Western Cities Project,* a multi-year research initiative examining a wide variety of municipal finance, social, infrastructure, environmental, and governance issues. The project's 30+ reports can be downloaded free of charge from the Canada West Foundation website *(www.cwf.ca).* The Foundation's *Rural West Initiative,* a one-year study that produced three research reports, provides additional insights.

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IDEAS CHANGE THE WORLD

2004 has the potential to be a year of great change in Canada: there has been a federal election, the future of our cities is a hot topic, Canada-US relations are evolving, and the nature of our democracy is being debated.

As Canadians talk about these issues, it is critical that the aspirations, perspectives, and ideas of western Canadians are heard.

Through its Western Cities, Building the New West and West in Canada Projects, the **CANADA WEST FOUNDATION** is actively working to generate ideas for positive change and to make sure that the views of western Canadians are an integral part of the national debates during this time of change.

HOW CAN YOU HELP?

Without ideas – and an organized effort to get them heard – change will not happen. This is what the Canada West Foundation does. But, we can't do it without your support. If you want to help ensure that western Canadian ideas are front and centre on the national stage, we invite you to become a FRIEND of the Canada West Foundation by making a donation. Please contact our Director of Finance and Administration Lori Zaremba (403.264.9535 ext. 347 or toll free 1.888.825.5293 or zaremba@cwf.ca) for more information.

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