Local Finance and Fiscal Equalization Schemes in a Comparative Perspective: Australia and Canada

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Enid Slack
Institute on Municipal Finance and Governance
Munk School of Global Affairs
University of Toronto
Introduction

- Horizontal fiscal imbalance – some municipalities are unable to provide an adequate level of services at reasonable tax rates

- Why?
  - costs may be higher
  - needs may be greater
  - tax base may be smaller

- State/local equalization grants allow municipalities with small tax base and high needs/costs to provide a comparable level of service at comparable tax rates
Outline of Presentation

- Background on local government
  - Australia
  - Canada
  - Germany

- State-local equalization in Australia
  - State of Victoria

- Provincial-local equalization in Canada
  - Province of Nova Scotia
  - Province of Ontario

- Implications for German local governments
### Background on Local Government

Table 1: Expenditures per Capita and Local Taxes in Three Countries, 2011
(Euros)

<table>
<thead>
<tr>
<th></th>
<th>Germany</th>
<th>Australia</th>
<th>Canada</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local government</td>
<td>2,523</td>
<td>1,011</td>
<td>3,151*</td>
</tr>
<tr>
<td>State government</td>
<td>4,160</td>
<td>6,831</td>
<td>8,650</td>
</tr>
<tr>
<td>Central government</td>
<td>9,613</td>
<td>12,625</td>
<td>6,890</td>
</tr>
<tr>
<td>Local taxes as % of total taxes</td>
<td>13.0</td>
<td>3.5</td>
<td>11.8</td>
</tr>
</tbody>
</table>

*Includes school boards and Aboriginal governments

Source: Calculated from IMF, Government Finance Statistics Yearbook, 2012
## Background on Local Government

### Distribution of Local Government Revenues, 2011 (%)

<table>
<thead>
<tr>
<th></th>
<th>Germany</th>
<th>Australia</th>
<th>Canada</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total revenue</strong></td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td><strong>Taxes</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxes</td>
<td>37.9</td>
<td>37.0</td>
<td>36.4</td>
</tr>
<tr>
<td>Taxes on income, profits and capital gains</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Individuals</td>
<td>14.5</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>- Corporations</td>
<td>15.8</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Taxes on payroll and workforce</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Taxes on property</td>
<td>5.1</td>
<td>37.0</td>
<td>35.5</td>
</tr>
<tr>
<td>Taxes on goods and services</td>
<td>2.5</td>
<td>0.0</td>
<td>0.9</td>
</tr>
<tr>
<td>Other taxes</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Grants</strong></td>
<td>35.5</td>
<td>16.8</td>
<td>47.1</td>
</tr>
<tr>
<td><strong>Other revenue</strong></td>
<td>26.6</td>
<td>46.2</td>
<td>16.6</td>
</tr>
</tbody>
</table>

Source: Calculated from IMF, Government Finance Statistics Yearbook, 2012
State-Local Equalization in Australia

- Central funding to state governments to local governments
- Local Grants Commissions
- General purpose grants plus local roads grants (all unconditional)
- National principles for allocation e.g. horizontal equalization; effort neutrality; minimum grant
State-Local Equalization in Australia

- Detailed expenditure need weighted by indicators that reflect differences in local conditions beyond the control of local government ("disabilities" or "cost adjustors"): 
  - need differences – e.g. age, income levels
  - cost differences -- e.g. economies of scale, population density

- Standard expenditure = population X average state expenditure per capita X disability factor
State-Local Equalization in Australia

- Revenue needs defined as revenues a council would raise if standardized revenue effort (tax rate) were applied to revenue base

- Revenue capacity = standard tax rate X assessment base (averaged over 3 years)

- Some states also include user charges in revenue capacity
State of Victoria

- 9 expenditure categories
- 14 disabilities /cost factors
- Revenue capacity includes property taxes, payments in lieu of taxes, user fees and charges
- 5 revenue adjustors
Australian Equalization: Observations

- Complexity with disability factors – but still subjective
- Lack of transparency
- Excludes capital expenditures
- Property tax – different assessment methods; other features not included in measure
- Does it reduce efficiency?
Canada – Nova Scotia

- Formula based on expenditure need and revenue raising ability

- Equalization within each of two classes of municipalities -- regional municipalities and towns versus counties and districts

- Compare “standard” expenditure and “standard” revenue

- Selected expenditures only – police, fire, roads, and some environmental

- Tax base – assessed value (not weighted to reflect tax differentials)
Nova Scotia - Observations

- Less than half of municipal expenditures included – incentive to use creative accounting

- Unweighted assessment does not reflect greater ability to raise revenues from commercial/industrial property

- Does not include revenues other than property tax

- Municipality cannot receive fewer grants than previous year – dilutes equalization impact
Canada: Ontario

- Context of provincial uploading; grant reduction
- Assessment equalization grant
- Northern and rural fiscal circumstances grant
  - support to municipalities with limited tax base
  - target funding to those with more challenging fiscal circumstances
  - transitional assistance so northern municipalities receive at least 95% of previous year’s allocation; others at least 85%; with more challenging circumstances – 100%
Canada: Ontario

- Primary indicators (50%) – weighted assessment per household and median per household income
- Secondary indicators (50%) – average annual change in assessment, employment rate, ratio of working age to dependent population, % of population below low-income threshold
- Municipal fiscal circumstances indicator (MFCI):
  - each indicator is scored relative to median
  - average indicator score of all indicators (weighted)
  - index measured on a scale from 0 to 10 (ranked municipalities)
Ontario - Observations

- Small number of exogenous variables
- Captures expenditure need and revenue raising ability
- Excludes state of the infrastructure as part of fiscal circumstances
- Only available to northern and rural municipalities
Implications for German Local Governments

- Different context – local property tax versus income tax
- Formula-based transfers – are they simple and transparent?
- Local Grants Commissions – are they needed?
- Differentiating among municipalities – does size matter?
- Expenditure need and revenue capacity – how to measure?
- Fiscal effort – should it be included?
- Incentive effects – what are they?
- Insurance against shocks – is there a moral hazard problem?