Financing Large Cities and Metropolitan Areas*

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According to economic theory, the major role assigned to local governments is to provide goods and services to residents within a particular geographic area who are willing to pay for them. If the benefits of particular services are confined to local jurisdictions (the actions of one municipality have no effect on other municipalities), efficiency is enhanced because the mix and level of services can vary according to local preferences. Local officials are in a better position to respond to local tastes and preferences than are central government officials. This theory of the role of local governments, however, does not distinguish among different types of local governments -- large metropolitan governments, intermediate-sized cities, or towns and villages. Yet, they are different.

Large cities and metropolitan areas are different than smaller urban or rural municipalities for the obvious reason that they have a much larger population. But, they are also different because they have a higher concentration of population and a population that is more heterogeneous in terms of social and economic circumstances. Moreover, large cities are the economic engines of their country – they are important generators of employment, wealth, and productivity growth. In the emerging global “knowledge-based economy,” innovation is the key to prosperity and most innovation occurs in large cities and metropolitan areas where people can enjoy the benefits of close proximity, known as agglomeration economies (Slack, Bourne, & Gertler, 2003). Large cities also serve as regional hubs for people from adjacent communities who come to work, shop, and use public services that are not available in their own communities.

From a municipal finance perspective, the unique characteristics of large cities and metropolitan areas have implications for the magnitude and complexity of the expenditures that local governments in those areas are required to make on municipal services as well as their ability to pay for services. Large cities and metropolitan areas can have greater fiscal autonomy than other urban or rural areas, both in terms of greater responsibility for local services and greater ability to levy their own taxes and collect their own revenues (Bird R., 1984). Yet, in few countries, do large cities and metropolitan areas receive any different treatment than any other municipality from senior governments (Bahl, 2010).

Municipal finance in metropolitan areas is further complicated by the existence of a multiplicity of local governments that provide services and raise revenues within a larger region. Because the political boundaries of individual local governments rarely coincide with the boundaries of the

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1 The literature on fiscal federalism assigns three roles to government: stabilization, income redistribution, and resource allocation. Stabilization policy is generally not considered to be an appropriate function of local governments because they do not have access to monetary policy and because capital and labour flow freely across local jurisdictions. In the case of redistribution, local efforts to address income disparities will likely result in the movement of high-income groups to low-tax areas and low-income groups to high-tax areas. Nevertheless, local governments do engage in redistribution through the act of taxing and spending. See (Bird & Slack, 1993, p. 16).

2 Studies of metropolitan areas use different terms to describe them. These include, for example, metropolitan cities, metropolitan regions, city-regions, and urban regions. Generally, these terms refer to cities with a large urban core plus adjacent urban and rural areas that are integrated socially and economically with the core. See (Stren & Cameron, 2005) for a discussion of how the various terms are applied in different parts of the world.
economic region, there is a need to coordinate service delivery and share the costs on a region-wide basis. This problem is exacerbated by overlapping special purpose districts which are responsible for delivering specific services, such as water or electricity, and whose boundaries may not be coterminous with either local or regional governments. Although finance and governance are closely intertwined, the issue of governance of metropolitan areas is not discussed further in this paper.

This paper explores the financing of services and infrastructure in large cities and metropolitan areas by posing a series of questions: Do large cities spend more than smaller cities? Do larger cities have greater fiscal capacity? Are large cities treated differently than other cities? What are the appropriate revenue sources for large cities?

1. Do Large Cities Spend More?

Local government expenditures are generally higher in large metropolitan areas than other municipalities (Chernick & Reschovsky, 2006) and (Freire, 2001). A high concentration of people means more specialized police services; higher densities mean more specialized training and equipment for fire fighters. A high concentration of poverty and special needs within large metropolitan areas requires higher expenditures on social services, social housing, and public health. Moreover, large cities compete on the international stage and, to be competitive, they need to provide services such as parks, recreational facilities, and cultural institutions in addition to the “hard” services such as transportation, water and sewers. People from outside the metropolitan area make use of the cultural facilities (as well as social and medical services) but may not contribute directly to the support of those facilities. Smaller cities, on the other hand, may not have a public transit system because the urban densities are not sufficient for a transit system to be economically viable. Cultural facilities (such as opera houses or art galleries) are unlikely to be provided in smaller urban areas because these facilities require a minimum size to make provision possible.

Net expenditures per capita in London, for example, were 48 percent above the average for England in 2008-09. Expenditures were higher on transport (147 percent above the average), housing (97 percent above the average, and police (88 percent above the average) (U.K. Department of Communities and Local Government, 2010). Part of the explanation for higher expenditures results from differences in ethnic diversity (one in four Londoners is from an ethnic minority), income disparities (London has the second highest unemployment rate among England’s regions) and of course its role as a global city in terms of finance and business services (Office of the Prime Minister, 2003).

Not only are local government expenditures higher in large metropolitan areas but they are particularly high in the central cities compared to the suburbs. Municipal per capita spending in the City of Toronto in 2008 was 50 percent higher than in both the Greater Toronto Area and the province (Kitchen, 2010). Higher overall expenditures are largely explained by higher

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3 There are exceptions, such as Cape Town, where the Municipal Demarcation Board sets the geographic boundary of the city to coincide with the economic region.

4 For a discussion of metropolitan governance, see (Slack, 2007) and (Bird & Slack, 2007).

5 Although they do not pay property taxes to the municipality, they may pay indirectly through municipal parking charges, taxes on restaurant meals, etc. They also pay taxes to other levels of government that may find their way back to the municipality in the form of intergovernmental transfers.
expenditures on social services, fire and police protection, and transit. Municipal per capita expenditures in the core city of Zurich exceed those in suburbs by more than double (Kubler & Rochat, 2010). In particular, expenditures are higher for culture, security, social welfare, traffic, and health.

Notwithstanding the need to make larger expenditures, particularly in central cities, there may be opportunities to benefit from lower expenditures per capita for metropolitan services to the extent that local governments can take advantage of economies of scale in service provision. Empirical evidence on the existence of economies of scale is mixed, however, depending on the service in question and the units of measurement (e.g. jurisdiction size or size of the facility) (Hermann, Horváth, Péteri, & Ungvári, 1999) and (Fox & Gurley, 2006). Economies of scale can generally be found for central administrative and governance functions and for services with large capital inputs such as public transportation and water and sewage systems (Chernick & Reschovsky, 2006) but it is less clear that there are economies of scale for other services such as education. The literature also suggests that it is possible that cities can become too large to deliver services efficiently and diseconomies of scale can set in.

2. Do Larger Cities Have Greater Fiscal Capacity?

As with expenditures, revenue patterns tend to be different in large metropolitan regions, reflecting both the different nature and level of services they provide and their greater ability to levy taxes. To the extent that cities rely on property tax revenues, for example, larger more densely populated cities have a larger per capita tax base than smaller cities or rural areas because of generally higher property values. Since commercial and industrial properties are almost always taxed at a higher rate than residential properties (Bird & Slack, 2004), large cities with a high proportion of commercial and industrial properties have greater ability to levy property taxes. Moreover, the existence of agglomeration economies in large cities implies that more of the taxes on commercial and industrial properties come from economic rents. This means that one dollar of commercial assessment in a large city has more tax capacity than one dollar of commercial assessment in a smaller municipality.

Large cities and metropolitan areas also have greater ability to levy income and sales taxes because of the higher level of economic activity that they experience. Sales taxes generate significant revenues for those large cities that attract people from neighbouring municipalities who come to shop or work. Indeed, sales taxes are one way to capture the benefits that commuters and visitors enjoy from using services in the municipality. Factors are less mobile in

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6 Cost differences are not the same as spending differences. Spending differences include differences in costs (based on factors beyond the control of the local government), local preferences for public services, and waste or inefficiency.

7 Many measurement problems have been identified in such cost studies. For example, population is commonly used as a proxy for output and expenditures as a proxy for costs. But population is not a good measure of output: two municipalities with the same population might have very different outputs for a particular service because of demographic differences. Expenditures are not a good measure of costs, in part because the pattern of expenditures may reflect differences in local government wealth. That is, the local government fiscal base is likely to be correlated with population size (Hermann, Horváth, Péteri, & Ungvári, 1999, p. 36), so that larger expenditures do not necessarily mean that costs are higher.
large geographic areas making it easier to levy taxes over the broader region with less likelihood that people will cross the municipal boundary to shop, for example.

Local revenues in central cities also tend to be higher than in the suburbs. In the case of Toronto, for example, per capita revenues are more than 50 percent higher in the city than in the suburbs, comparable to the difference in expenditures noted above (Kitchen, 2010). Per capita property taxes are somewhat higher than in the suburbs as are user fees. Provincial conditional transfers are higher in the city, reflecting a major cost sharing program for social welfare. Finally, Toronto is permitted to levy additional taxes that are not available to the suburban municipalities but these taxes do not bring in much additional revenue.

3. Are Large Cities and Metropolitan Areas Treated Differently?

Special financial arrangements for large metropolitan areas can be grouped under three broad areas: city-state status, special taxing powers, and special intergovernmental transfers (Bahl, 2010). Tokyo is an example of a city-state where the metropolitan government has both city and prefecture (state) status and, as a result, has greater taxing powers than other municipal governments in Japan. The German structure gives broader responsibilities to “city-states” (Berlin, Bremen, and Hamburg). In addition to their Land (state) responsibilities such as education, security, and social policy, city-states perform the functions a local government (transportation, housing, daycare, etc.) (Zimmermann, 2009, p. 110). City-states also collect the same revenues as state governments and local governments (see the example of Berlin in Table 1).

In some countries, large cities have been granted additional taxing powers: Toronto relies heavily on property taxes but can also levy other taxes such as a vehicle registration fee, a land transfer tax, and a billboard tax (see Table 1). New York City levies a wider range of taxes than other US cities and, in particular, corporate income and business taxes (see Table 1). Yet, London levies only a local residential property tax (council tax).

A recent study of local governments in the U.S. found that the largest local governments raise just over 60 percent of their general revenues from own sources compared to less than 60 percent for all other local governments (Chernick, Langley, & Reschovsky, 2010). Governments in the largest U.S. cities rely much less heavily on property taxes than do local governments in the smaller municipalities: the property tax represents only 56 percent of tax revenue for the large cities compared to 77 percent for the smaller cities. The larger cities rely more heavily on the general sales tax, the individual income tax, selective sales taxes, and the corporate income tax compared with local governments in smaller municipalities.

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8 The authors used a concept which they refer to as “constructed” city governments for the largest local governments in the U.S. They compiled a measure of total taxes and other revenues paid by taxpayers for each large city by including revenues collected by the municipal government and the overlapping portion of the independent school districts and county governments.
Table 1: Local Taxes in Four Cities

<table>
<thead>
<tr>
<th>Berlin</th>
<th>Toronto</th>
<th>New York</th>
<th>London</th>
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<tbody>
<tr>
<td><strong>Land taxes and tax shares:</strong></td>
<td><strong>Local taxes:</strong></td>
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<td><strong>Local taxes:</strong></td>
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<tr>
<td>Share of corporate income tax</td>
<td>Property tax</td>
<td>General property tax</td>
<td>Council tax (residential property tax)</td>
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<td>Share of capital income tax</td>
<td>Land transfer tax</td>
<td>General sales tax</td>
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<td>Real estate transfer tax</td>
<td>Vehicle registration tax</td>
<td>Personal income tax</td>
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<tr>
<td>Motor vehicle tax</td>
<td>(repealed in 2011)</td>
<td>General corporation tax</td>
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<td>Inheritance tax</td>
<td>Billboard tax</td>
<td>Commercial occupancy tax</td>
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<td>Tax on betting and lotteries</td>
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<td>Banking corporation tax</td>
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<td>Fire protection tax</td>
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<td>Utility tax</td>
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<td>Beer tax</td>
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<td>Unincorporated business tax</td>
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<td><strong>Land plus local shares:</strong></td>
<td></td>
<td>Real property transfer tax</td>
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<tr>
<td>Personal income tax</td>
<td></td>
<td>Mortgage recording tax</td>
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<tr>
<td>Business tax</td>
<td></td>
<td>Tax audit revenues</td>
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<tr>
<td><strong>Local taxes:</strong></td>
<td></td>
<td>Cigarette tax</td>
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<tr>
<td>Real estate tax</td>
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<td>Hotel tax</td>
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<td>Entertainment tax</td>
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<td>Dog tax</td>
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<td>Second home tax</td>
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Although one might expect that large metropolitan governments depend less heavily on intergovernmental transfers, the reality is mixed. Metropolitan areas in some countries do not rely as much on intergovernmental transfers as smaller local governments – for example, Stockholm, Paris, Madrid, and Lausanne (Bahl, 2010). Core municipalities in metropolitan areas in Eastern Europe, however, do rely heavily on intergovernmental transfers (Bahl, 2010). For some capital cities (for example, Berlin, Bern, and Brussels), the federal government provides grants for specific services such as transportation, parks or cultural facilities. In most capital cities, however, little additional compensation is provided (Slack & Chattopadhyay, 2009).

4. What are the Appropriate Revenue Sources for Large Cities?

In general, the revenue sources that are available to large cities and metropolitan areas should reflect the expenditure responsibilities that they are required to undertake: “local authorities’ financial resources shall be commensurate with the responsibilities provided for by the constitution and the law” (European Charter of Local Self-Government (Article 9, Paragraph 2)). Moreover, metropolitan areas should also be as self-sufficient as possible. This section reviews some funding options.

4.1 User Charges

Local governments should, wherever possible, charge directly for services (Bird R. M., 2001). Appropriately designed user fees allow residents and businesses to know how much they are paying for the services they receive from local governments. When proper prices are charged,
governments can make efficient decisions about how much to provide and citizens can make efficient decisions about how much to consume. User charges are especially appropriate for services such as water and public transit where benefits are confined largely to individual consumers.

Charges are especially important in large metropolitan areas because they not only result in more efficient use of services but also encourage more efficient land use. If marginal cost pricing is used, higher fees are charged to consumers who are far away from existing services and hence more costly to serve, and lower fees are charged to consumers who are closer. Uniform pricing of urban services, while often politically appealing, is inherently economically inefficient. Under-pricing and distortions in water and sewer pricing can result in severe locational distortions, for example. An additional important benefit of more appropriate pricing of urban services is to reduce pressure on urban finances indirectly by reducing the apparent need for more investment in under-priced infrastructure.

A common reaction to suggestions to increase reliance on user charge financing is that the results are simply too regressive to contemplate. In reality, almost the opposite is true in large urban areas: those who benefit most from under-pricing services are those who make the most use of them, and the poor are not well-represented in this group (Bird & Miller, 1989). Relatively simple pricing systems such as low initial ‘life-line’ charges for the first block of service use can often deal adequately with any remaining perceived inequity from introducing more adequate pricing systems.9

4.2 Taxes

The traditional theory of fiscal federalism prescribes a very limited tax base for local governments. The only good taxes are said to be those that are easy to administer locally, that are imposed mainly on local residents, and that do not raise problems of harmonization or competition either horizontally (between local governments) or vertically (between local and central governments). The following sets out some tax options.

Property Tax

The property tax is appropriate for financing local services for at least two reasons. First, real property is immovable: it cannot move away when it is taxed. Second, there is a connection between the types of services funded at the local level and the benefit to property values. To the extent that the property tax approximates the benefits received from local services, it is like a benefit tax. Residential property taxes are particularly appropriate to fund local governments because they are borne by local residents.10 Those who enjoy the benefits of local services are required to pay for them.

The non-residential portion of the property tax – generally the most important part of the tax in many countries – is less appropriate for financing local government expenditures, however (Slack, 2010) and (Bird, Slack, & Tassonyi, 2010). Because taxes on business may be partially

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9 For extensive discussions of local user charges, see (Bird & Tsiopoulos, 1997).
10 For a more accurate and more detailed discussion of property tax incidence, see (Bird & Slack, 1993).
exported to residents of other jurisdictions who are consumers of the products or services produced in those properties, there is less accountability with this tax -- those bearing the burden of the tax are not the same as those enjoying the benefits. To the extent such taxes exceed the benefits received by business from local government activities and are exported to residents of other jurisdictions, restrictions may be needed such as a maximum rate or at least a requirement that a uniform rate be levied on residential and non-residential property. As noted earlier, however, the existence of agglomeration economies means that larger cities have rents they can exploit to some extent both by taxing non-residential property more heavily than residential property and much more heavily than non-residential property in smaller places.

Despite their many virtues as a source of local revenues, property taxes restrict revenue flexibility because no country seems to be able to raise more than 10 percent of total tax revenues from the property tax (OECD, 2006). That is partly because the tax is relatively costly and difficult to administer properly, and these problems are exacerbated as the size of the tax burden increases. Moreover, in most countries even a well-administered local property tax cannot finance major social expenditures (education, health, social assistance). Local governments financed primarily by property taxes must either confine their activities essentially to providing such local services as street cleaning and refuse removal or remain heavily dependent on transfers from senior levels of government. Finally, property tax revenues respond less quickly to changes in the economy than taxes on income or sales because economic growth is not capitalized fully into real estate investment and land ownership. Moreover, in many countries, even if property values do increase, assessed values are not updated on a regular basis (Bird & Slack, 2004).

**Income Tax**

A strong case can be made for a local income tax to supplement property taxes for large metropolitan areas. Even within the largest metropolitan areas, however, it is probably desirable to ‘piggyback’ onto higher-level income taxes (that is, to levy the tax as a supplement to a central or provincial/state income tax) rather than to impose independent local taxes.

A metropolitan income tax can be justified on the grounds that governments in large metropolitan areas are increasingly being called upon to address issues of poverty, crime, land use planning, regional transportation, and other region-wide needs (Nowlan, 1994). To the extent that large metropolitan areas are required to provide social services, an income tax is a more appropriate revenue source than a property tax because it is more closely related to ability to pay. Furthermore, since mobility across jurisdictions in response to tax differentials is less the larger the geographic area, large metropolitan areas are more able than other local governments to take advantage of income taxes. A quite different justification for income taxes for large metropolitan areas might be on benefit grounds. Since the residential property tax is tied to the consumption of housing rather than the consumption of public goods even this portion of the property tax is a benefit tax only to the extent that housing consumption and local goods consumption are highly correlated across different households (Thirsk, 1982). In large metropolitan areas with a heterogeneous population, however, in all likelihood income is more highly correlated with consumption of public services than it is with property value.
Because income taxes increase or decrease in response to changes in wages and salaries, revenues respond immediately to changes in the economy. The responsiveness of income taxes to changes in the local economy provides an advantage for cities that levy income taxes in an economic boom, but it may become a problem in an economic downturn.

Sales Tax

General sales taxes are generally levied by state/provincial governments but some local jurisdictions in the US levy a retail sales tax (Due & Mikesell, 1994). As long as municipal services are funded only from property taxes imposed on local residents, some users might escape paying taxes for services consumed. Broadening the local tax base to include sales would help to address some of the externalities in municipal services (where some beneficiaries of services, such as commuters and visitors, do not pay for them), would give municipalities greater flexibility and breadth in determining their own tax structure, and would allow municipalities to benefit from growth in the economy. A sales tax is also preferred to an income tax because, unlike the income tax, it does not tax savings.

Nevertheless, evasion problems can erode the tax base as well as being economically distorting. Large rate differentials between neighbouring jurisdictions are unlikely to be sustainable over long periods of time. Piggybacking onto the central or provincial/state tax system with an additional city “piggyback” sales tax of 1 or 2 percent, however, would avoid many of the problems associated with a local sales tax, including high administrative and compliance costs.

Selective Sales Taxes

Taxes on automobiles such as fuel taxes, vehicle registration levies, parking fees, and tolls on major roads both discourage road use and produce revenues. The most important tax on automobiles from a revenue perspective is the fuel tax, which is also the simplest and cheapest from an administrative perspective. Fuel taxes can generally be levied at the regional level. Moreover, different regions could impose taxes at different rates if they chose to do so since they would probably not be able to differ much from the rates imposed by their neighbours, given the mobility of the tax base. Cities that levy a fuel tax generally piggyback onto state/provincial fuel taxes, principally because the administrative costs of levying their own taxes would be prohibitive. The revenues generated from these taxes are often earmarked for local roads and transit services.

If automotive taxation is intended to price either the use of publicly provided services or externalities (congestion and pollution), however, fuel taxes are at best a crude instrument. Tolls and an appropriate set of annual automobile and driver license fees are preferable. For example, vehicle fees might be based on such features as age and engine size (older and larger cars generally contribute more to pollution), location of the vehicle (cars in cities add more to pollution and to congestion), and axle weight (heavier vehicles do exponentially more damage to roads and require roads that are more costly to build). Road tolls and congestion charges have been used successfully, for example, in Singapore and London.
Business Tax

Many countries have regional and local business taxes in the form of corporate income taxes, capital taxes, non-residential property taxes, transit taxes (octroi), license fees (patente), and various forms of industry and commerce taxes (Bird R. M., 2003). Most of these taxes would not score highly on most reasonable criteria. Few are equitable. Almost none are neutral. Most accentuate the disparities between localities, giving most to those who have most -- though this may of course make them especially attractive to metropolitan areas. Most also lend themselves to tax exporting, thereby violating the correspondence principle that those who pay should be those who benefit. The tax tends to be costly to administer.

Nonetheless, local governments generally impose taxes on local business. Such taxes are popular with officials and citizens for several reasons. They often produce substantial revenue and are more responsive to economic growth than property taxes. Moreover, in many countries, local governments have more discretion over the rate, base, and application of such taxes than of any other form of taxation. Since no one is quite sure of the incidence of such taxes, it is easy to claim that they are paid by someone other than local residents, which makes them politically palatable.

There is a good economic case for local business taxation as a form of generalized benefit tax. Specific public services benefitting specific businesses should be paid for by appropriate user charges but where user charges are not feasible, some form of broadly-based, general levy on business activity may be warranted. This argument suggests that a broadly based levy neutral to factor mix, such as a tax on value added, is likely the best form of local business tax (Bird R. M., 2003). Such a tax exists in Italy (Bordignon, Gianni, & Panteghini, 2001), was adopted in 2004 in Japan, came into effect in 2010 in France, and was recently proposed in South Africa.

4.3 Intergovernmental Transfers

As noted earlier, large cities and metropolitan areas have greater ability to levy and collect their own revenues than smaller cities. They have less need to rely on grants from senior levels of government as a result. Grants to large cities and metropolitan areas should thus probably be less on a per capita basis than grants to smaller and rural municipalities. There will still be cases, however, where some intergovernmental transfers are needed for large cities and metropolitan areas where they are providing services where the benefits spill over municipal boundaries (Slack, 2007). In large metropolitan areas some externalities can be internalized within the jurisdiction if boundaries are extended to include all of the users of the service. Nonetheless, for services that generate externalities beyond the borders of the metropolitan area -- for example, services that clearly contribute to international competitiveness -- some transfers may still be appropriate.

On the whole, in both principle and practice transfers are less important for large metropolitan areas than for other local governments. Indeed, in countries with wide regional economic disparities, there seems to be no reason why the wealthiest regions (including large metropolitan areas) should not be able to raise and spend most of their budgets themselves -- although even they seem likely to remain to some extent transfer-dependent when it comes to financing
education and health. To achieve this goal, however, and to reduce their present dependence on intergovernmental transfers, not only do large metropolitan areas need an appropriate governing structure, but they also as a rule need more and different revenue sources than other local governments.

4.4 Financing Infrastructure

Municipal infrastructure is essential to the economic, social, and environmental health of cities. Cities not only have to provide roads, transit, water, sewers, and other “hard” services, they also have to provide “soft” services that enhance the quality of life in their communities such as parks, libraries, social housing, and recreational facilities. Metropolitan infrastructure should generally be financed locally, and often by borrowing. Other ways to pay for infrastructure include development charges and public-private partnerships.

Borrowing

Borrowing is an appropriate way to pay for capital expenditures. Where the benefits of a capital investment (for example, the construction of a water treatment plant) are enjoyed over a long period of time, say 25 years, it is both fair and efficient to pay for the project at least in part by borrowing so that the stream of benefits matches the stream of costs through the payment of debt charges. On the whole, large metropolitan areas tend to have greater access to bond markets than smaller municipalities and generally pay lower servicing costs.

Borrowing allows a municipality to enjoy the immediate benefit from the capital improvement, which is not always possible when relying on current revenues (taxes and user fees) which are usually not sufficient to fund large expenditures on a “pay-as-you-go basis.” The pattern of capital expenditures is lumpy and this means that a municipality may find it needs substantial funds to finance an infrastructure project one year and then the need declines for a few years. Borrowing allows municipalities to avoid large year-to-year fluctuations in tax rates.

The main disadvantage of borrowing from a municipal perspective is that potential revenues are dedicated to debt repayment and are thus not available for other uses. When the costs are spread over time, a significant portion of local budgets becomes a fixed obligation and debt charges can constrain local fiscal flexibility. A municipality with low debt has more flexibility to respond to unanticipated future events.

Development Charges

A development charge is a one-time levy imposed on developers to finance growth-related capital costs associated with new development (or, in some cases, redevelopment). These charges are levied for works constructed by the municipality, and the funds collected are used to pay for the infrastructure made necessary by the development. The rationale for charging developers for such costs is that “growth should pay for itself” and not be a burden on existing taxpayers.11

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11 Many other levies are sometimes imposed on developers: land dedications that require the developer to set aside land for roadways, other public works, school sites, or for environmental reasons; parkland dedications that require a portion of the land used for development to be set aside for parkland or that a cash payment in lieu of parkland be
Who ultimately pays development charges – the new buyer, developers, or pre-development landowners – depends largely upon the demand and supply conditions in the market for new housing (Slack & Bird, 1991). Over the long term, however, it seems likely that most charges imposed for new housing developments are borne by buyers. If properly implemented, such development charges can act, in effect, as a form of marginal cost pricing and hence induce more efficient development patterns and discourage urban sprawl (Slack, 2002). To do so, charges have to be differentiated by location to reflect the different infrastructure costs.

Public-Private Partnerships

Public-private partnerships (known as P3s) are partnerships between a government body and a private sector party whereby the private sector provides infrastructure or services that have traditionally been delivered by the public sector. P3s do not necessarily mean full privatization; the government body retains ownership of the assets and sets the policies and level of service. P3s are widely used in the U.S. and Europe, prompted by an interest in improving the efficiency and effectiveness of local public service delivery.

One of the main advantages of partnerships is that, by relieving municipalities of the financial responsibility for up-front capital costs, they enable infrastructure to be built at times when government funding is constrained (Tassonyi, 1997). Since many municipalities do not like to borrow or are unable to borrow, P3s are one way to get facilities built without the municipality incurring debt. The operation of facilities and programs by private operators also reduces municipal operating expenditures and may enable additional sources of revenue to be collected. Ancillary uses such as retail can be accommodated within facilities to provide another source of revenue. Finally, the public sector can draw on private sector experience and skill.

There are, nevertheless, potential risks associated with public-private partnerships (Tassonyi, 1997). For the private sector, there are risks that the regulatory framework could change and cause delays in the project. For the public sector, there is the risk that the nature of the public services provided will not be what the public wants. The success of a partnership depends on how the contractual arrangements are structured and how the risks are shared.

4.5 Concluding Comments

Large cities and metropolitan areas are often not treated any differently than smaller cities and towns … but they should be. Metropolitan regions can and should be essentially self-financing through user fees and taxes. Proper pricing through user fees will result in an efficient allocation of resources. The property tax is a good tax for local government but, given that it is relatively inelastic, highly visible, and politically contentious, it will not be sufficient to fund the increasing demands on governments in metropolitan areas. Access to a portfolio of taxes would provide stability (through the property tax) and elasticity (through income, sales, or business taxes).

made; density bonusing, under which developers are granted higher densities than permitted in return for meeting conditions such as providing day care, preserving an historic building etc.; connection fees to permit developers to buy into existing capacity of water and sewer facilities; and over-sizing provisions (sometimes called front-end financing) that require developers to provide more infrastructure than is strictly required for their development.
Grants to large cities and metropolitan areas should probably be less on a per capita basis than grants to smaller municipalities but may still include transfers for health and education and other services where the benefits spill over municipal boundaries. Finally, metropolitan governments should use a combination of borrowing, development charges, and public-private partnerships to finance infrastructure.
Works Cited


