

# A Fiscal Federalism Framework for Financing Infrastructure

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State of the Federation Conference, June 4-6, 2015

"Canadian Federalism and Infrastructure"

# Introduction

- | Canada alleged to have serious infrastructure deficit, but evidence limited
  - | Congestion, crumbling bridges, rail lines, class sizes, wait lists, contaminated water, food vulnerability
  - | Productivity of public infrastructure
- | Focus instead on implications of decentralized responsibility for infrastructure
  - | Does decentralization lead to under-provision of infrastructure?
  - | How should intergovernmental fiscal arrangements address infrastructure?
- | Surprisingly little guidance in fiscal federalism literature

Begin with outline of current arrangements

Then turn to fiscal federalism context

## Assignment of Responsibilities

- | Federal government responsible for interprovincial transport, defence establishments, First Nations infrastructure, pipelines and telecommunications
- | Provinces responsible for provincial roads, intercity transit, schools & hospitals; oversee municipal infrastructure
- | Municipalities responsible for roads, buses, garbage and sewage, water, libraries, recreation facilities
- | Provinces & municipalities responsible for local works other than those extending beyond a province, and those declared by Parliament to be of general advantage to Canada
- | Sections 36(1), 36(2) commitments relevant: equal opportunities, economic development, essential public services, equalization
- | Efficiency in internal economic union a national objective

## Sources of Finance

- | Infrastructure spending highly decentralized

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## Provincial and Municipal Taxing Powers

- | Provinces have unrestricted taxing & borrowing powers, constrained by tax room occupied by federal government
- | Decentralization of revenue-raising has consequences
  - | Could jeopardize tax harmonization
  - |

# Federal-Provincial Transfers

## 1. Equalization

- | Both provincial and municipal property taxes are included
- | Significant horizontal imbalances remain: resource-rich provinces not equalized down
- | Needs for infrastructure not equalized, but revenues are

## 2. Social transfers: CHT/CST

- | Equal per capita transfers, so net revenue-equalizing except for resource revenues
- | Mainly serve to fill vertical fiscal gap, but growth rate less than growth of provincial spending
- | No distinction between current and capital program costs

## 3.

## Infrastructure Transfers: Further Details

- | PTIC: equal per capita based on prov requests for prov & mun projects that contribute to objectives related to economic growth, a clean environment and stronger communities; cost-shared with provinces, municipalities, P3s, non-pro ts
- | NIC: for mainly transportation projects of national significance; cost-shared
- | GTF: equal per capita to provinces for municipal infrastructure
- | Accountability: Up-front application and back-end provincial-municipal reports
- | Feds do not deal directly with municipalities, but in uence via criteria
- | Canada 150 infrastructure fund: once-o program to renovate municipal facilities
- | 2015 Federal Budget: 2017-18 annual \$1bn infrastructure fund for private-public partnerships

# Provincial-Municipal Transfers



# Federal Role in Financing Provincial Infrastructure

1. Provincial infrastructure spending may have spillover effects, but these can be positive or negative
  - ┆ Positive: Shared-cost harmonizing grants; block conditional grants; user fees; out-of-province reimbursements
  - ┆ Negative: Expenditure competition for province-building, exacerbated if fiscal capacities differ
2. Section 36(1) of the Constitution: Equalization and social transfers, regional development agencies, NIC grants, federal infrastructure (Dodge)
3. Efficiency in internal economic union and international trade
4. Case for federal infrastructure grants limited, given provinces' incentives to invest in infrastructure
5. Vertical fiscal imbalance may constrain ability of provinces to finance infrastructure; but, addressed via general transfers

## Provincial Role in Financing Municipal Infrastructure

- | Beneficial spillovers addressed by provincial grants, regulations and supervisory oversight address that, amalgamation
- | Much municipal infrastructure benefits local residents and businesses: No systematic incentive to invest too little
- | Shortage of municipal infrastructure due to ongoing tendency for urbanization and (im)migration: backlogs
- | Perceived shortage of discretionary finance: but, studies show that there is room for property taxes and user fees to provide sufficient finance for municipal expenditures
- | Property tax may be relied on too heavily, especially for education and social services, and especially for bigger cities with growing infrastructure needs
- | Case for more municipal revenue tools rather than infrastructure grants

## Further Issue facing Municipalities

### Municipal infrastructure financing constrained by vertical fiscal imbalance

- | Downloading of financing of provincial public services to property tax (education, social services)
- | Tendency for federal government to pass on fiscal deficits to provinces has parallel at provincial-municipal level
- | Provincial-municipal transfers not systematically equalizing in all provinces: Municipalities with the most needs and costs are most financially stretched
- | Lack of municipal fiscal discretion and access to more flexible revenue sources detract from ability to respond to infrastructure needs in a timely fashion (although it mitigates



# Further Issue affecting Arguments for Transfers

## Pricing/taxing of municipal services

- | Discussion of infrastructure deficit does not take account of consequences of proper pricing of municipal infrastructure
- | Efficient pricing complicated by scale economies, differential demand, capacity constraints, externalities/second best
- | Purpose of pricing should be to establish link between services received and charge or tax for them
- | Infrastructure grants should be conditional on implementation of efficient pricing and taxation policies at municipal level

## Issues with the Current Arrangements for Financing Infrastructure

- | Equalization, CHT/CST do take account of infrastructure and municipal spending
- | Transfers may be inadequate if there is vertical fiscal imbalance: VFI causes crowding out of infrastructure spending by growth in public services: suggests adjustment in tax room and general transfers, not infrastructure grants
- | Horizontal imbalance strains infrastructure for have-not provinces: province-building by resource-rich provinces
- | Infrastructure investments delivered by provinces may serve a national purpose: spillovers, equity, opportunity, regional development (Sec 36(1)), antidote to Dutch disease?, internal

## Two General Observations

Hard to support Premier's argument for permanent infrastructure-specific grant over and above the all-purpose grants that already exist. To the extent there is vertical imbalance, better to address it by tax room &/or general transfers

One possible argument of infrastructure shortage: short-sightedness of provincial/municipal politicians leads to underinvestment in infrastructure. Then, infrastructure grants act as commitment device. (This relies on federal politicians being more far-sighted than provincial/municipal)





# Implications for Intergovernmental Fiscal Arrangements

- | Governments have ample incentives and constitutional right to invest in needed infrastructure  
Exception: spillovers, national efficiency/equity objectives
- | Most provincial infrastructure needs could be financed by own-source revenues, borrowing and unconditional transfers (Equalization, CHT/CST)
- | Most municipal infrastructure projects could be financed by own-source revenues (incl. user fees), borrowing and conditional provincial transfers
- | Provincial/municipal infrastructure deficits largely reflect vertical imbalance, and can be addressed by some combination of transfers and tax room
- | Vertical imbalance growing over time: Tie growth of social transfers to average rate of growth of social program spending

# Implications for Intergovernmental Fiscal Arrangements

- | Equalization system leaves considerable horizontal imbalance because of resource revenues, leading to differential ability to provide infrastructure
- | Provincial-municipal vertical imbalance harder to address because of constraints on municipalities
  - | Additional sources of revenue for large municipalities: other taxes, user fees
  - | Less reliance on property taxes for education and social services
  - | Better needs-based municipal equalization systems
- | Infrastructure projects of national interest
  - | Improve efficiency in the internal economic union
  - | Contribute to national growth, productivity, innovation
  - | Improve equity in social union (equality of opportunity, regional development)
  - | Often best delivered by provinces or municipalities supported by project-specific cost-sharing grants, rather than broad, dedicated infrastructure grant

## Concluding Remarks

- | Principle of subsidiarity supports high degree of decentralized responsibility for infrastructure
- | Local infrastructure financing and provision not constrained by fiscal competition problems
- | Federal government 2846 cm 0 g2r5.6817 cm BT /F16 10.9091