“Smart” Metropolitan Finance

Presentation to Smart Cities Workshop
Mumbai, India
May 19, 2017

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Finance follows function ...
follows governance
Financing Smart Metropolitan Cities

• Cities are important drivers of productivity, innovation, and economic growth

• To realize potential of a smart city, need “hard” services (water, sewers, and roads) and “soft” services (cultural facilities, parks, and libraries)

• Good services and infrastructure will attract skilled workers and provide a good quality of life for residents

• Cities that fail to provide these services will lose their economic advantage

• How do we pay for services and infrastructure?
Outline of Presentation

- Decisions on public spending need to be linked with revenue decisions

- User fees, property taxes, land value capture, development charges, transfers, borrowing, P3s

- Cities around the world levy a range of taxes

- Mumbai and Toronto

- Large cities would benefit from a mix of taxes; cities should set their own tax rates

- We need to build public fiscal trust

- Concluding comments
Decisions on public spending need to be linked to revenue decisions

- Those who make expenditure decisions should make revenue decisions

- Direct linkage between taxes and expenditures:
  - more accountable government
  - taxpayers less averse to paying taxes when they know where their tax dollars are being spent

- Revenue tool should match expenditure being funded
Different Services – Different Revenue Sources

**Private**
- Water
- Sewers
- Garbage
- Transit

**Public**
- Police
- Fire
- Local parks
- Streetlights

**Redistributive**
- Social assistance
- Social housing

**Spillovers**
- Roads/transit
- Culture
- Social assistance

**Revenue Sources**
- User Fees
- Property Tax
- Sales Tax
- Income Tax
- Transfers
Different Infrastructure – Different Fiscal Tools

- User fees
  - identifiable beneficiaries (transit, water)

- Taxes
  - short asset life (police cars, computers)

- Land value capture taxes
  - increase property values (transit)

- Development charges
  - growth-related costs; new development or redevelopment (water, roads, sewers)

- Transfers
  - spill over municipal boundaries (roads, transit)

- Borrowing
  - large scale assets with long life (roads, bridges)

- P3s
  - large in scale; revenue stream; measurable results (toll roads)
User fees bring in revenues and alter economic decisions

- Properly designed fees enable citizens to make efficient decisions about how much of a service to consume and governments to make efficient decisions about how much of the service to provide

- Under-pricing (or not charging) leads to:
  - over-consumption and demands to build more under-priced infrastructure
  - redistribution of income that is not what is otherwise expected or desired – rich may benefit more than the poor

- Regressivity can be addressed e.g. lifeline rates for water
The property tax is a good tax for local government

• Immobile tax base

• Fair based on the benefits received from local government services

• Predictable and stable revenue

• Visibility -- makes tax accountable and transparent

BUT

• Difficult to increase or reform the tax
Land value capture is on the rise

• Recoup some or all of the unearned increment in land values arising from:
  • public investment
  • change in regulations (e.g. increased density, building height)

• Rationale: at least some of the resulting increase in land value arising from infrastructure investment should be captured by governments to pay for it
How do we capture land value?

- Betterment levies/special assessments (e.g. special assessments for sidewalks in Toronto; supplementary business property tax in London to help pay for transit – Crossrail)

- Tax increment financing (e.g. to redevelop areas in need of revitalization in Chicago)

- Sale of building rights (e.g. density bonusing in Toronto; community amenity contributions in Vancouver; CEPACs in São Paulo)
Development charges are used to pay for growth

- Covers growth-related capital cost associated with new development
- Off-site infrastructure (e.g. highways, sewer lines, etc.)
- Growth pays for itself
- Impact on land use
Intergovernmental transfers: pros and cons

Grants for equalization and to address spillovers but:

• break the link between those who benefit/those who pay

• not stable and predictable funding

• no incentive to use proper pricing

• conditional transfers distort local decision-making

• accountability problems when two or more levels of government fund the same service
Borrowing for assets with long life

• Inter-generational equity – those who enjoy the benefits over time also pay the costs

• Capital expenditures are lumpy; borrowing smooths out the costs

• Pooling borrowing can lower costs

• Borrowing costs may crowd out current expenditures
Public-Private Partnerships

- Public sector can draw on private sector expertise; innovation
- Potential for cost savings with competition
- Potential loss of control for the public sector
- Private borrowing costs may be greater than public borrowing costs
## Taxes in Cities Around the World

<table>
<thead>
<tr>
<th></th>
<th>Toronto</th>
<th>Paris</th>
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<tbody>
<tr>
<td></td>
<td>Property tax</td>
<td>Business value added tax</td>
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<td></td>
<td>Land transfer tax</td>
<td>Property taxes (including residence tax, business owners’ property tax and commercial floor area tax)</td>
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<td>Billboard tax</td>
<td>Flat-rate tax on network companies</td>
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<td>Frankfurt</td>
<td>Local trade tax</td>
<td>Household waste removal tax</td>
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<td>Property tax</td>
<td>Street cleaning tax</td>
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<td>Tax on gambling</td>
<td>Parking fees</td>
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<td>Dog tax</td>
<td>Electricity tax</td>
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<td>Land transfer tax</td>
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<td>**Shared taxes : ***</td>
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<td>Income</td>
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<td>Value added tax</td>
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<td>Tokyo</td>
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<td>Metropolitan inhabitant tax on individuals, corporations, interest income</td>
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<td>Enterprise tax on individuals and corporations</td>
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<tr>
<td>Madrid</td>
<td>Property tax</td>
<td>Real property acquisition tax</td>
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<td>Business tax</td>
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<td>Vehicle tax</td>
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<td>Tax on land value increase</td>
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<td>**Shared taxes : ***</td>
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<td>Personal income tax</td>
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<td>Value added tax</td>
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<td>Excise taxes</td>
<td>- alcohol and spirits</td>
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<td>- beer</td>
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<td>- tobacco</td>
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<td>Note: Shared taxes are marked with *</td>
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**IMFG**

Institute on Municipal Finance & Governance at the School of Global Affairs, University of Toronto
<table>
<thead>
<tr>
<th>Berlin</th>
<th>New York</th>
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<tbody>
<tr>
<td><strong>State (land) taxes:</strong></td>
<td>Real estate taxes (including payments in lieu)</td>
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<tr>
<td>Race betting and lottery tax</td>
<td><strong>Sales and use taxes:</strong></td>
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<td>Beer tax</td>
<td>General sales</td>
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<td>Real estate transfer tax</td>
<td>Cigarette</td>
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<td>Inheritance tax</td>
<td>Commercial motor vehicle</td>
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<td>Fire brigade tax</td>
<td>Mortgage</td>
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<td><strong>Local taxes:</strong></td>
<td>Stock transfer</td>
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<td>Trade tax</td>
<td>Auto use</td>
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<td>Property tax</td>
<td><strong>Income taxes:</strong></td>
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<td>Dog tax</td>
<td>Personal income</td>
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<td>Entertainment tax</td>
<td>General corporation</td>
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<tr>
<td>Second home tax</td>
<td>Financial corporation</td>
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<td><strong>Share of state taxes:</strong></td>
<td>Unincorporated business income</td>
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<tr>
<td>Income tax</td>
<td>Personal income (non-resident city employees)</td>
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<tr>
<td>Value added tax</td>
<td>Utility</td>
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<tr>
<td><strong>Share of national taxes:</strong></td>
<td><strong>Other taxes:</strong></td>
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<tr>
<td>Wage tax</td>
<td>Hotel room occupancy</td>
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<td>Allocated income tax</td>
<td>Commercial rent</td>
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<tr>
<td>Corporate tax</td>
<td>Horse race admissions</td>
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<tr>
<td>Capital income tax</td>
<td>Conveyance of real property</td>
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<td>Solidarity charge</td>
<td>Beer and liquor excise</td>
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<td>Customs</td>
<td>Taxi medallion transfer</td>
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<tr>
<td><strong>London</strong></td>
<td>Surcharge on liquor licences</td>
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<tr>
<td>Property tax (council tax plus business rate supplement)</td>
<td>Refunds of other taxes</td>
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<tr>
<td><strong>Shared tax:</strong></td>
<td>Off-track betting surtax</td>
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<tr>
<td>Non-domestic rates (non-res. property tax)</td>
<td><strong>Note:</strong> Shared taxes are marked with *</td>
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Mumbai and Toronto

Photo by Vidur Malhotra via Flickr (http://bit.ly/2pDxHcB)

Photo by Dennis Jarvis via Flickr (http://bit.ly/2onUGrk)
# Mumbai and Toronto: Expenditures

<table>
<thead>
<tr>
<th>Mumbai</th>
<th>Toronto</th>
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<tbody>
<tr>
<td>Roads and bridges, water, sewers, public works, solid waste</td>
<td>Water, sewers, waste management, roads and transit, fire protection,</td>
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<tr>
<td>management, sanitation, public</td>
<td>police protection, planning, parks, recreation, arts and culture,</td>
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<tr>
<td>markets and slaughter houses,</td>
<td>public health, social services, social housing, economic development</td>
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<tr>
<td>public health, primary health care, primary education, arts and</td>
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<td>culture, fire, parks and gardens, urban forestry, amusement, planning</td>
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<tr>
<td>and buildings</td>
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</tbody>
</table>
Mumbai: Revenues

- Other income: 18%
- Investment income: 6%
- Grants, contributions and subsidies: 2%
- Fees and user charges: 32%
- Taxes: 42%

Mumbai: Tax Breakdown

- Octroi and toll: 54%
- Property tax: 11%
- Water tax: 11%
- Sewerage tax: 11%
- Education tax: 5%
- Fire tax: 2%
- Street tax: 6%
- Other: 0%
Toronto: Operating Revenues

- Rate Supported, 14%
- Other, 7%
- Reserve, Transfer from Capital, Investment Income, 7%
- Federal Grants, 1%
- User Fees & Fines, 16%
- Provincial Grants, 17%
- Taxes, 38%

Toronto: Tax Revenue Breakdown

- Property Taxes, 88%
- Municipal Land Transfer Tax (MLTT), 12%
Cities benefit from a mix of taxes

• A mix of taxes gives cities flexibility to:

  • respond to local conditions such as changes in the economy, evolving demographics, and expenditure needs

  • achieve revenue growth, revenue stability, and fairness in its impact on taxpayers
Cities should set their own tax rates

• It would be administratively cost efficient if cities ‘piggybacked’ onto the state tax with the state government collecting the revenue and remitting it to cities

• It is critical, however, that cities set their own tax rate. In this way, they would be accountable to taxpayers through the linking of taxes to the services consumed
Public fiscal trust

- Good information
- Good communications
- Real engagement
- Building credibility
- Earmarking funds
Final Comments

• Metropolitan areas should have greater fiscal autonomy than other urban areas –
  • greater responsibility for local services
  • greater ability to levy own taxes, collect own revenues, and borrow for capital expenditures
  • less dependence on intergovernmental transfers

BUT

• need to cultivate public trust
• need a governance structure that will allow them to levy taxes on a metropolitan-wide basis