Financing Metropolitan Cities: Understanding the Need for Different Approaches and Strategies

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Four Questions

❑ Are metropolitan areas different?

❑ What are the implications for municipal expenditures and revenues?

❑ Which revenues are appropriate for metropolitan areas?

❑ Why does governance matter?

Are metropolitan areas different?

Are Metropolitan Areas Different?

❑ Population:
- ❑ Larger
- ❑ More concentrated
- ❑ More heterogeneous

❑ Economy:
- ❑ Important drivers of economic growth, wealth, and productivity
- ❑ Innovation occurs where there are agglomeration economies

❑ Regional hubs:
- ❑ People from adjacent communities come to work, shop, use services

What are the Implications for Municipal Expenditures and Revenues?

Implications for Municipal Expenditures

- ❑ Higher crime rates -- more expenditure on policing
- ❑ More spending on public health and social services
- ❑ Taller buildings require more specialized training and equipment for fire fighters
- ❑ Need a good public transit system
- ❑ "Hard" and "soft" services and infrastructure to compete internationally

Do Metropolitan Areas Spend More?

❑ **Metros spend more**

- Six South African metros -- 34 percent of population but 59 percent of total local government expenditures (Steytler 2010)

❑ **Central cities spend more than suburbs**

- São Paulo – central city population more than half of the metropolitan region but expenditures are twice that of suburban municipalities (Arretche 2011)
- Toronto – central city expenditures are 1.5 times suburban expenditures (Kitchen 2011)

Implications for Municipal Revenues – Greater Fiscal Capacity

❑ Property tax:

❑ higher property values mean larger per capita property tax base

❑ above average commercial and industrial tax bases

❑ higher agglomeration "rents"

❑ ability to impose relatively higher taxes without losing tax base to competitive localities

Implications for Municipal Revenues – Greater Fiscal Capacity

❑ Income and sales taxes:

  ❑ Higher level of economic activity -- greater ability to levy income and sales taxes (if allowed)

  ❑ Sales tax attractive when commuters and visitors from neighboring areas visit the city to work, shop, or visit cultural/recreational facilities

  ❑ Broader geographic area of metropolitan government makes it easier to impose taxes

Which Revenues are Appropriate for Metropolitan Areas?

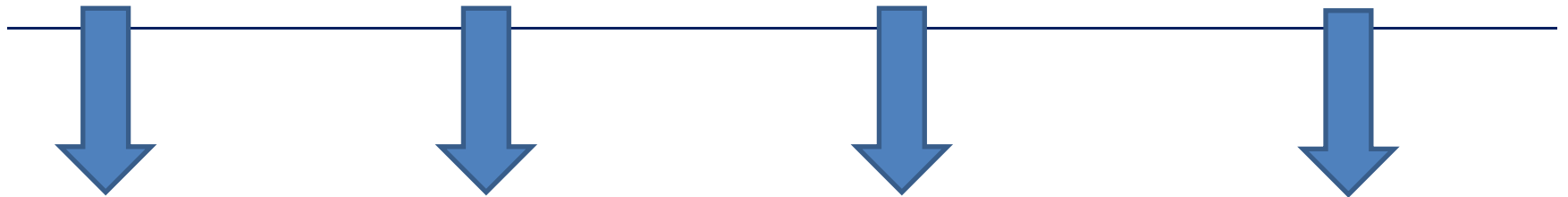# Different Types of Services – Different Financial Tools

Private	**Public**	**Redistributive**	**Spillovers**
Water	Police	Social assist.	Roads/transit
Sewers	Fire	Social housing	Culture
Garbage	Local parks		Social assistance
Transit	Street lights		

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User fees	**Property tax** **Sales tax**	**Income tax**	**Transfers**

Which Revenues for Metropolitan Areas?

- ❑   Own-source revenues

- ❑   Intergovernmental transfers

- ❑   Sources of capital finance

Why Own-Source Revenues?

❑ Own-source revenues:
  ❑ user fees, taxes, other non-tax revenues
  ❑ local discretion to modify revenues

❑ As much as possible, each government should finance expenditures out of own revenues:
  ❑ provides needed revenues

   PLUS …

Why Own-Source Revenues?

❑ Local autonomy and flexibility

❑ Accountability of public officials to taxpayers for revenues raised

❑ Expenditure efficiency -- provide what citizens want and not waste resources

❑ Fiscal responsibility – limits demand for public spending and pressure for more transfers from other levels of government

❑ Stability and predictability of revenues

A Mix of Taxes for Metropolitan Areas

❑   Metropolitan cities should have access to a mix of taxes:

    ❑ to provide a stable source of revenue for local governments – property tax

    ❑ enough elasticity to finance expanding services in large and rapidly growing urban areas (income, sales, business taxes)

Intergovernmental Transfers

❑   Metropolitan cities should rely less on transfers than other local governments

❑   Provided ... they have diverse revenue sources and appropriate governing structure

❑   But ... some transfers for "hub" or nodal services for national transportation or other networks contributing to competitiveness may be needed

Distribution of Own-Source Revenues, Shared Taxes, and Transfers
Selected Cities
(%)

	Own-source revenues	Shared taxes	Intergovernmental transfers
London (2011/12)	26.2		73.9
Berlin (2010)	39.5	35.0	25.5
Madrid (2009)	58.5	4.5	37.0
New York (2011)	69.1	9.5	30.9
Paris (2011)	82.5		17.5
Tokyo (2010)	82.3*		7.7
* Includes some taxes with limited metropolitan flexibility over tax rate setting			

Sources of Capital Financing

❑ Borrowing can be a good way to pay for capital expenditures

❑ Development charges can help make growth pay for itself

❑ Public-private partnerships relieve municipalities of up-front costs but have potential risks

❑ Land value capture

Why does governance matter?

Governance of Metropolitan Areas

❑ Metropolitan areas are generally characterized by many small, fragmented local governments and public agencies; few metropolitan governments

❑Lack of metropolitan governing structure:

- ❑ tax competition
- ❑ constraint on providing local services efficiently
- ❑ difficult to coordinate service delivery across local boundaries
- ❑ hard to share costs fairly

Concluding Comments

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❑ Metropolitan areas are different than other cities and towns

❑ Greater per capita expenditures

❑ Greater fiscal capacity

Concluding Comments

❑ Metropolitan areas should have greater fiscal autonomy than other urban or rural 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

❑ they need a governance structure that will allow them to levy taxes on a metropolitan-wide basis