Institutional Analysis Assignment: Final Paper

PPG1000 – Governance and Institutions

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Introduction and Problem Statement

Over the past 50 years the levels of infrastructure spending by the Federal and municipal governments have effectively reversed, despite no corresponding change in the ability of municipalities to raise revenue (Mackenzie 2013, 8). Municipalities still provide the majority of public infrastructure (Association of Municipalities of Ontario 2016) and exist as the closest and most tangible example of government in the lives of most citizens. The Association of Municipalities of Ontario has made the infrastructure funding gap a key priority, linking it with municipal fiscal sustainability, much as cities like Edmonton or Vancouver already have (Association of Municipalities of Ontario 2016; Edmonton City Council's Infrastructure Strategy 2006, 7-8; City of Vancouver Budget 2016, 31). While one estimate places the shortfall at $123 billion for maintenance of existing infrastructure and $115 billion for new investment (Mirza 2007, 15), and others differ from as low as $50 billion to as high as $570 billion (Di Matteo), there is a general consensus that the gap exists and will require serious government investment over the next decade.

This fiscal gap, however, has itself been caused by a lack of accountability from the Provinces. Under section 92.8 of the *Constitution Act, 1867*, Provincial legislatures have exclusive authority to create and control municipalities, leaving Canadian cities without any ability to tax and spend which is not directly delegated by the Province in their constituting statute (*Constitution Act, 1867*). As such, and leaving aside the insufficient taxation powers some municipalities do have, funding for municipal infrastructure comes in the form of grants from the Provincial and Federal governments, with the Province maintaining final say on how funds must be spent. This institutional arrangement produces what Enid Slack terms a "vertical fiscal

imbalance", wherein municipal revenue streams are simply insufficient for meeting necessary investments in infrastructure (Slack 2009, 17).

Taking Ontario as a pertinent example, this means that the $160 billion the Ontario government has dedicated to infrastructure spending in its 2016 Budget will be spread over sectors as disparate as "education infrastructure" and "health and community infrastructure" (Budget 2016, Ch. 1(b)). As for Federal infrastructure spending, the Fraser Institute recently pointed out how nearly half of the current government's infrastructure funding is earmarked for Federal infrastructure and government properties (Lammam and MacIntyre 2016). In short, both levels of government have historically been inconsistent in municipal infrastructure funding, often using it to pursue their own policy goals (Bech-Hansen 2016, 4-5). As such, any potential solution to the municipal infrastructure funding gap must address this underlying accountability gap in a way that won't be easily reversed with the next change of government. The following outlines precisely such a solution.

First, the paper covers existing and proposed answers to the infrastructure deficit. Then, the paper turns to describing a proposed Federal law which would establish an independent Board tasked with determining municipal infrastructure needs, and how the resulting recommendations would then be appended to an unconditional Federal revenue transfer. The purpose, as outlined below, would not be to bridge the infrastructure deficit in and of itself, but to end the accountability gap which has created the deficit in the first place. It would do so by allowing municipalities, citizens, and interest groups a clear and impartial avenue for pressuring Provincial governments into properly funding municipal infrastructure when they would, and still could, otherwise allocate those funds.

Jurisdictional Scan

Infrastructure Bank

One solution currently being implemented by the Federal government is the creation of a national "Infrastructure Bank" that, once backed by an initial public capitalization, will attract private investment in order to finance infrastructure spending (Minister of Infrastructure and Communities Mandate Letter). Although the details of its formation are still being finalized, the Government of Canada noted in its 2016 Budget how the Infrastructure Bank would initially be capitalized using $15 billion of government money currently spent on infrastructure and $20 billion from the Bank's acquisition of various debt or equity assets, with the remaining four-fifths of funding coming from private investment (Canada, Fall Economic Statement 2016, Chapter 2). The Infrastructure Bank is a promising idea and could, in theory, fund infrastructure for generations. However, it remains to be seen how such a scheme would work in practice, on what conditions it would disburse funds, and how the Bank's liquidity could be reliably maintained while negotiating between often tumultuous global financial markets and the desired terms of large institutional investors.

Improving Intergovernmental Relationships

Another possible solution would be for municipalities to promote steadier relationships with their Federal and Provincial counterparts in order to gain greater access to own-source revenue streams through amendments to their constituting statutes (Kitchen 2006, 3, 18-19). This is indeed one of the main solutions proffered by Slack in order to close the "vertical fiscal imbalance" (Slack 2009, 17). There is obviously currency in such proposals, as the Government of Ontario is currently in the process of amending the *Municipal Act, 2001* in order to allow municipalities to make their own investment decisions according to the "prudent investor"

standard (*An Act to amend various Acts in relation to municipalities* 2016, s. 76). This, however, seems to be the only new revenue stream given to municipalities, scuttling hopes for more substantial reforms for the next five years (Ontario, Ministry of Municipal Affairs and Housing, Municipal Legislation Review). Furthermore, the efficacy of such proposals remains contingent on shifting political and economic tides, as well as natural differences in the capabilities of municipalities to generate and manage investments.

Constitutional Amendment

A solution which would get to the core of the accountability gap at the root of the municipal infrastructure deficit is a constitutional amendment affording municipalities the liberty to design fiscal policies and potentially even shield them from future unfunded mandates from higher orders of government (Ciccarelli-Shand 2016 57-59, citing Broadbent 2008). In the United States, the *Constitution of Michigan* has mandated revenue-transfers from State to local governments since 1963, and these provisions have since been strengthened by multiple Ballot Proposals prohibiting the State of Michigan from further reducing its level of funding for (or from downloading any new unfunded mandates to) local governments (*Constitution of Michigan*, art. 9, ss. 6, 10, 25-34; Taxpayers for Michigan Constitutional Government 2016). This has provided a steady source of revenue for local governments, totalling approximately $783.9 million in 2016 alone (*Constitution of Michigan*, art. 9, s. 10; Michigan Department of Treasury 2015, 1).

However, the *Constitution of Michigan* has since been interpreted by Michigan Courts as an expression of "taxpayer revolt" on the part of citizens, inhibiting the ability to find against taxpayer claimants and thereby opening the door to a multitude of (oftentimes parochial) legal challenges against the fiscal policies of both State and local governments (Faulhaber 2000, 219-

221, 255-257). The practical result is that the *Constitution of Michigan* enforces rigid funding formulas, tying the hands of the Michigan government and further contributing to shortages in local government revenue (Michigan State University 2016). One clear piece of evidence in support of this is the lawsuit the State of Michigan is currently facing, brought by several local governments, claiming that a miscalculation in the constitutional revenue sharing formula has left them over $1 billion short of funding (Taxpayers for Michigan Constitutional Government 2016; Lavelle 2014; Southeast Michigan Council of Governments 2014, 18).

In the Canadian context such an amendment would require Provinces to cede control over their most economically and politically important jurisdictions, by way of amending s. 92.8 of the *Constitution Act, 1867*. Moreover, it would still need to meet the requirements of the amending formula in s. 38(1)(b) of the *Charter, 1982*, which necessitates approval of both Houses of Parliament and the Legislatures of at least two-thirds of Canada's provinces totalling at least half of the country's population (*Constitution Act*, 1982). Many have recognized how politically unrealistic this is and how jealously Provinces would guard their own jurisdiction over municipalities (Ciccarelli-Shand 2016, 57-58, citing Sancton 2008 and Slayton 2015; Library of Parliament 2006).

Legislative Innovation

Perhaps the most tangible and robust solution to the municipal infrastructure deficit could be in a statutorily mandated revenue sharing regime. In Manitoba, for instance, Provincial revenue from income and fuel taxes has been shared with municipalities for over a decade. In 2005, *The Municipal Taxation and Funding Act* was amended to create the "Building Manitoba

Fund" (*The Municipal Taxation and Funding Act*, s. 7).[1] The Building Manitoba Fund is a Provincial account which annually sets aside the greater of either 1/7th of Provincial Sales Tax revenue, or 4.15% of personal and corporate income tax, $0.02/litre of provincial gasoline tax, and $0.01/litre of provincial diesel tax, which is thereafter used by the Province "only for the payment of municipal grants and for expenses incurred by the government in support of local capital projects" (*The Municipal Taxation and Funding Act*, ss. 7-8). In practice, the Building Manitoba Fund remains a reliable source of funding which has provided Winnipeg alone with approximately $206 million in each of 2015 and 2016, and overall Manitoba is dedicating $327.2 million in funding for local infrastructure in 2016-2017 (Government of Manitoba, Grants and Payments; Government of Manitoba, Building Manitoba Fund).

Nevertheless, the majority of municipal infrastructure investment in Manitoba still comes by way of *ad hoc* Provincial grants and payments, and the majority of municipal own-source revenue still comes from property taxes and fees (Grace 2013, 404-405). Funding, moreover, remains conditional on being spent on infrastructure projects alone, and the Manitoba government retains the absolute discretion to attach further reporting, auditing, and spending requirements to the grants (Slack 2009, 19; *The Municipal Taxation and Funding Act*, s. 10).[2] Such conditional transfers, according to Slack and Kitchen, run contrary to the principles of transparency, accountability, and efficiency that are necessary for any sustainable investment in municipal infrastructure, which they suggest should be unconditional in order to promote fiscal responsibility on behalf of both municipal governments and their taxpayers (Slack and Kitchen 2016, 26). Though it is certainly true that any Provincial funding restrictions must take into

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[1] There is a dearth of academic commentary regarding the policy formulation and implementation of the "Building Manitoba Fund", and the University of Toronto Library system has an index to the Hansard Digests for the Legislative Assembly of Manitoba which unfortunately starts in 2007.

[2] Saskatchewan, it should be noted, also shares part of its PST revenue with municipalities, while other municipalities receive a portion of fuel tax revenues (see Slack and Kitchen 2016, 8).

account the different infrastructure needs of different municipalities (Federation of Canadian Municipalities 2008, 11), there is no obvious reason why closing the infrastructure deficit requires unconditional financial transfers or the delegation of greater revenue-generating powers to local governments, nor is it clear how such a solution could ever be implemented nationwide given the constitutional constraints already discussed.

Proposed Solution

The solution proposed below envisions the introduction of a novel Federal law, titled the *Provincial-Municipal Infrastructure Funding Partnership Act*. The law would earmark a portion of income tax, which would otherwise be returned to its province of origin, for the provinces to voluntarily transfer back to municipalities. In essence, the law's purpose would be to end the accountability gap outlined above, as Provinces would face direct political pressure for not funding municipalities at the Federally recommended levels, creating a dynamic which could indirectly solve the infrastructure deficit.

In practice, the law would be divided into three parts. Part I would create a Federal administrative Board, tasked with organizing every Canadian municipality into a number of cohorts representing different levels of required funding. The Board would have discretion to determine the number of cohorts, potentially allowing for each municipality to have its own tailored needs-based cohort. But in reaching a determination for each municipality or each cohort of municipalities, the Board would be explicitly required by its constituting statute to take into consideration certain characteristics, such as population and demographic trends, local and regional economic conditions, and stated infrastructure needs. The Board would also conduct its own research into municipal infrastructure deficits, drawing from government data and

voluntary, structured, and publicly reported input from all levels of government and civil society regarding needs, spending priorities, and pre-existing funding mechanisms.

Part II of the *Provincial-Municipal Infrastructure Funding Partnership Act* would detail how the Board's determination of infrastructure needs per cohort would then be matched against a substantial designated revenue stream, such as Federally collected income tax, destined for unconditional return to the Province and not for any national equalization payments. This is not to be confused with the revenue stream used to initially establish the Board, which could come from the Gas Tax Fund already intended for municipal infrastructure investment (as discussed below). Part III would then cover execution of the law. Ultimately, the Board's findings regarding each cohort's infrastructure needs (Part I) would be used to calculate a recommended dollar amount of how much of the designated revenue stream (Part II) should be used for municipal infrastructure spending (Part III). In other words, the Province would still receive the income taxes it was entitled to, but with new publicly reported and voluntary recommendations of how much should be given to or used in each municipality or cohort in order to satisfy Board-determined levels of infrastructure needs.

Implementation

The *Provincial-Municipal Infrastructure Funding Partnership Act* would be introduced through the regular law-making channels of Parliament, but would involve multiple departments given its unique status as an administrative board. In practice, the Ministry of Finance and Infrastructure Canada would play the largest *de facto* roles, but the daily staffing and budgetary needs of the Board would be supplied by the Administrative Tribunals Support Service of Canada, whose formal head is Canada's Justice Minister (Canada, Administrative Tribunals Support Service of Canada).

Infrastructure Canada would likely prepare submissions for the Federal government under Part I and, in order to remain revenue-neutral (albeit on a government-wide level), the Board could be established by drawing on the Gas Tax Fund transfer payment, which is already used for municipal infrastructure investment in the "Permanent and Flexible Infrastructure Funding" program (Infrastructure Canada, Report on Plans and Priorities, 2.1.1 Program: Funding for Provincial-Territorial Priorities). The Ministry of Finance, on the other hand, would receive the publicly available funding recommendations made by the Board and simply append them to each income tax revenue transfer to each Province under the "Transfer and Taxation Payment Programs" (Finance Canada, Departmental Performance Report 2015-16, Program 1.2: Transfer and Taxation Payment Programs).

Put simply, the Board's publicized recommendations would be forwarded by the Ministry of Finance to each province annually, and would outline how much funding each municipality or cohort should be allocated for infrastructure spending, either by direct transfer to the municipality or by provincial grants and projects. It is worthwhile noting that the actual revenue stream to which the recommendations would be attached need not be the income tax transfer, but must be both unconditional and substantial enough to meet the Board's infrastructure investment targets. The reason for creating an administrative body to conduct research, solicit input and make public recommendations, rather than another budgetary unit within Infrastructure Canada, would be to ensure transparency in both its recommendations as well as the methods used in their determination. Although the Federal government could influence Board appointments, in this way the work of the Board would be shielded from outside influence, leaving it free to develop its own research protocols and subject-area expertise.

Anticipated Outcome and Evaluation

The true objective of the *Provincial-Municipal Infrastructure Funding Partnership Act* would be to end the lack of municipal infrastructure spending by institutionalizing a "comply or explain" dynamic at the Federal level. It is important to reiterate that the Board recommendations forwarded by the Ministry of Finance to provincial governments are in no way directly binding; they would merely create an avenue for public opinion and political pressure to be brought to bear on Provincial governments that refuse to earmark the recommended amount of revenue for municipal infrastructure. Put simply, Provinces would be *de facto* required to either comply with the spending recommendations or explain why not.

This system of regulation was first used in European corporate governance codes, and was recently applied to the Canadian corporate governance context in order to help address the under-representation of women in senior roles within publicly traded companies. In 2014-2015, several Canadian securities exchange regulators adopted a uniform directive requiring non-venture publicly traded companies to include information on female representation, hiring targets, and policies for nominating women to positions as Directors or Officers as part of their statutory disclosure regime, or "explain its reasons for not doing so" (Ontario Securities Commission 2015, Staff Review of Women on Boards and in Executive Officer Positions – Compliance with NI 58-101 Disclosure of Corporate Governance Practices).

Although this obviously engages questions regarding the sufficiency of an "explanation" or the factors influencing the calculations that corporate boards make in order to decide whether or not to comply, such questions go to the enforcement mechanisms available to securities regulators. The *Provincial-Municipal Infrastructure Funding Partnership Act*, on the other hand, would leave any response to provincial non-compliance to municipalities and their citizens. In

practice, since the introduction of "comply or explain" disclosure requirements there has been a steady increase in female representation in Director roles and increased consideration for hiring women as Officers, despite the reality that companies could easily justify non-compliance on the basis of company-specific circumstances (CSA Multilateral Staff Notice 58-308 2016, 3-4; Luo and Salterio 2014, 460–481).

As a result of being indirectly forced to "comply or explain" their funding decisions, Provincial governments can be expected to react with hostility towards the *Provincial-Municipal Infrastructure Funding Partnership Act*, which would be perceived as a form of encroachment on their constitutionally defined jurisdiction over municipalities. In the political realm, Provinces would be expected to voice their concerns regarding the fiscal impact of the law, especially regarding its choice of revenue stream, either individually or collectively through the Council of the Federation. Similarly, Provinces would likely raise legal concerns regarding the constitutionality of the *Provincial-Municipal Infrastructure Funding Partnership Act*, arguing that it indirectly disrupts the division of powers and violates their sovereignty over municipalities under section 92.8 of the *Constitution Act, 1867* (*Constitution Act, 1867*). Nevertheless, both arguments fall flat when faced with the non-binding nature of the recommendations made by the statutory Board.

Firstly, the Federal government could find justification for its action in the field of municipal infrastructure under section 91 of the *Constitution Act, 1867*, which empowers Parliament to pass laws regarding the "good Government of Canada" or "The Regulation of Trade and Commerce" (*Constitution Act, 1867*). Secondly, it is worth reiterating that the proposed law does not create any new taxes at either the Federal or Provincial levels, leaves income tax transfers to the Provinces unaltered, and produces entirely non-binding

recommendations on funding allocations. Perhaps most importantly, the non-binding nature of the "comply or explain" dynamic created by the *Provincial-Municipal Infrastructure Funding Partnership Act* falls squarely within the doctrine of cooperative federalism envisioned in the jurisprudence of the Supreme Court of Canada (SCC). According to the doctrine of cooperative federalism, where Federal and Provincial governments share concurrent jurisdiction over a specific regulatory field, constitutionally sound legislation should be designed in a manner which facilitates cooperation between both orders of government without encroaching on their otherwise distinct spheres of responsibility (*Quebec (AG) v Canada (AG)* 2015, para. 17). This was clearly stated in *Reference re Securities Act*, where the SCC held that a law creating a Federal securities regulator would be unconstitutional, but that nonetheless "a cooperative approach that permits a scheme that recognizes the essentially provincial nature of securities regulation while allowing Parliament to deal with genuinely national concerns remains available" (*Reference re Securities Act* 2011, para. 130).

The voluntary nature of the recommendations created by the Board mandated under the *Provincial-Municipal Infrastructure Funding Partnership Act* fit these criteria precisely. The "comply or explain" dynamic created by the law would be entirely unenforceable by any government, but the non-partisan and public nature of the Board's research and findings would create a (direct) avenue for (indirect) enforcement through intergovernmental advocacy and political pressure from municipalities and their residents. Moreover, it is worth noting that this form of regulatory regime imbues the entire process with what some philosophers term "discursive" or "deliberative legitimacy". Deliberative legitimacy, in its most basic articulation, is the legitimacy a collective decision has if the claims for and against it have been articulated and justified to those impacted by the decision (Dryzek 2001, 651-669; Bohman and Rehg 2014,

"Jürgen Habermas"). Under the *Provincial-Municipal Infrastructure Funding Partnership Act* this occurs at two points: first with the Board's consideration of inputs and claims made by all levels of government and civil society stakeholders, and again with the Province's adoption or publicly justified refusal of the Board's recommendations regarding municipal infrastructure funding.

Criteria for evaluating the efficacy of the *Provincial-Municipal Infrastructure Funding Partnership Act* would, however, be unable to incorporate such considerations. As such, any evaluation would tend to focus on compliance and would interrogate whether or not Provinces actually allocated the recommended levels of funding towards municipal infrastructure and, in cases where they deviated from the recommendations, how large was the deviation, what justifications were given, and what, if any, consequences did the Province face as a result.

Conclusion

The approach to bridging the municipal infrastructure funding gap outlined above is constitutionally sound, revenue neutral, and creates a political dynamic which is informed by multi-stakeholder collaboration and both partisan and non-partisan input. It does not, however, guarantee funding levels or revenue sources for municipalities. As such, the *Provincial-Municipal Infrastructure Funding Partnership Act's* success remains entirely contingent on participation and collaboration from all levels of government, as well as a degree of ownership from civil society. While this may never actually amount to increased funding for municipalities, it is the only known proposal which institutionalizes collaboration and political accountability for the fiscal choices of all levels of government. This, as outlined above, is the true source of the funding gap and is thus a necessary, though certainly not sufficient, first step towards a solution.

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