Governance and Finance of Large Metropolitan Areas in Federal Countries

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Cities are engines of economic growth

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

- Need for “hard” services (water, sewers, and roads) and “soft” services (cultural facilities, parks, and libraries) to attract skilled workers

- Cities that fail to provide these services will lose their economic advantage
Outline of presentation

- Why does governance matter?
- Governance models in metropolitan areas
  - Criteria for evaluating governance models
  - Five models of governance ... with examples
  - Evidence from OECD countries
- How to pay for metropolitan services
- Final observations on governance and finance
Governance in Metropolitan Areas
Why does governance matter?

- Metropolitan governance is critical to how:
  - services are delivered efficiently
  - service delivery is coordinated across the metropolitan area
  - costs are shared
  - citizens access local government
  - local governments are responsive and accountable
Why does governance matter?

- Metropolitan governance matters for service delivery:
  - **Transportation:** Need to coordinate transportation across municipal boundaries; need to ensure access to employment and services; need to coordinate transportation and regional land use
  - **Water:** Need to determine where treatment facilities will be located
  - **Solid waste:** Need to determine where garbage disposal sites will be located
  - **Policing:** Need to fight crime across municipal boundaries
  - **Social services, health and education:** Need to decide on level of expenditures and how to share costs
Why does governance matter?

- Metropolitan governance matters for economic development:
  - Quality of the **business environment** affects investment and economic growth
  - Impact on **productivity:**
    - Larger cities enjoy agglomeration economies
    - Fragmented governance could increase cost of doing business because of need to deal with many local offices, ineffective planning and traffic congestion
  - **Coordination** of economic development activities reduces harmful competition within the metropolitan area
Balancing regional and local interests: criteria to evaluate governance models

- Efficiency
  - Ability to achieve economies of scale
  - Ability to reduce negative spillovers (externalities) across local boundaries

- Equity: ability to share costs and benefits of services fairly across the metropolitan area

- Accessibility and accountability for decision-making

- Local responsiveness/competition
Five models

- One-tier fragmented government structures
- One-tier consolidated government structures
- Two-tier government model
- City-state
- Voluntary cooperation/special purpose districts

*A metropolitan area can reflect more than one model*
# Examples from Nine Federal Countries

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<thead>
<tr>
<th>Country</th>
<th>Metropolitan Area</th>
<th>Governance Model</th>
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<td>Australia</td>
<td>South East Queensland (Brisbane)</td>
<td>One-tier; strong state role</td>
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<td>Perth</td>
<td>Fragmented local governments; strong state role</td>
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<tr>
<td>Brazil</td>
<td>Belo Horizonte</td>
<td>Voluntary cooperation; state government in charge of shared functions; inter-municipal cooperation</td>
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<td>São Paulo</td>
<td>Special purpose districts; state role</td>
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<tr>
<td>Canada</td>
<td>Toronto</td>
<td>One-tier consolidated</td>
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<td>Vancouver</td>
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<tr>
<td>Germany</td>
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<td>Voluntary cooperation</td>
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<td></td>
<td>Hamburg</td>
<td>Voluntary cooperation</td>
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<tr>
<td>India</td>
<td>Hyderabad</td>
<td>Amalgamation; special purpose agencies</td>
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<td></td>
<td>Mumbai</td>
<td>Special purpose agencies</td>
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<tr>
<td>South Africa</td>
<td>Gauteng city region</td>
<td>3 metros; limited inter-municipal cooperation</td>
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<td></td>
<td>Cape Town</td>
<td>One-tier consolidated</td>
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<tr>
<td>Spain</td>
<td>Barcelona</td>
<td>Two-tier</td>
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<td></td>
<td>Madrid</td>
<td>Two-tier</td>
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<tr>
<td>Switzerland</td>
<td>Geneva</td>
<td>Purpose-oriented intergovernmental cooperation</td>
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<td></td>
<td>Zurich</td>
<td>Purpose-oriented intergovernmental cooperation</td>
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<tr>
<td>United States</td>
<td>Louisville</td>
<td>Consolidated one-tier</td>
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<tr>
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<td>Los Angeles</td>
<td>Fragmented one-tier</td>
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</tbody>
</table>
Fragmented One-Tier

- Many local governments operate in metropolitan area with independence in choosing public services and fees, taxes, and debt financing

- Local autonomy, responsiveness, competition

- Inability to address spillovers; lack of coordination of services, planning and economic development; cost of services not shared equitably across metropolitan area
Fragmented One-Tier Structures

- Los Angeles – 200 cities and 5 county governments
- Geneva – 74 municipalities
- Sydney – 43 local councils
- Mumbai – 7 municipal corporations, 13 municipal councils, parts of two districts, more than 900 villages, 21 parastatals

Examples of inter-municipal cooperation to follow
One-Tier Consolidated

- Metropolitan government with powers to deliver services and raise revenues across metropolitan area
- Economies of scale; redistribution between rich and poor areas; coordination of service delivery; internalizes externalities; more choices for efficient taxation
- Threat to local autonomy, responsiveness, and citizen engagement
  - Innovative mechanisms – open government; participatory budgeting
- Reduces competition among municipalities – weakened incentives to be efficient
- What is the appropriate boundary?
Consolidated One-Tier Structures

- Cape Town – geographic boundary coincides with economic region

- Toronto – a city too big and too small
Two-Tier

- Upper tier provides services that are region-wide; lower tiers provide local services

- Upper tier: economies of scale, redistribution, internalize externalities

- Lower tiers: access and accountability

- Costs may be higher because of duplication

- May be less transparent and more confusing for citizens
Two-Tier Structures

- Barcelona – Metropolitan council plus 36 lower tiers

- Vancouver – regional district plus 21 municipalities, 2 unincorporated areas, and one municipality for parks only

- Portland, Oregon – Metro government plus 25 municipalities in 3 counties and several unincorporated areas
City-States

- City and state powers
- Internalize externalities, region-wide taxation, broad-based taxes, enhanced borrowing powers
- Expansion of boundaries into other states is difficult
- Tensions between city-state governments and central government
City-States

- Berlin, Bremen, Hamburg
  - more legal powers than cities
  - more revenue tools

BUT

- territory does not always cover entire urban agglomeration
Special Purpose Districts

- Single function placed under control of special district; may have access to dedicated revenue stream (e.g. user fee or earmarked tax)

- Easy to create politically; easy to disband; local autonomy; economies of scale; address externalities

- Potential problems of accountability; redistribution not automatic

- No regional vision
Special Purpose Districts

- Greater ABC Region in São Paulo (“bottom up”)

- Parastatals in Mumbai delivering a range of services

- Purpose-oriented intergovernmental cooperation (e.g. waste disposal, energy supply) in Swiss metropolitan areas
Evidence from OECD countries

- Review of governance structures in 275 metropolitan areas in OECD countries

- Main functions for metropolitan organizations:
  - regional economic development
  - spatial planning
  - transportation

Source: Ahrend, Gamper, and Schumann (2014)
Evidence from OECD countries

- Few powers; small budgets

- Yet, where there are metropolitan organizations – metropolitan areas perform better than fragmented local governments:
  - denser
  - higher per capita GDP
  - attract more people
  - higher level of public satisfaction with public transport
  - lower levels of air pollution

Source: Ahrend, Gamper, and Schumann (2014)
Evidence on governance and productivity

- Study of Germany, Mexico, Spain, United Kingdom, United States

- Fragmented governance structures tend to have lower levels of productivity (measured by wage premiums)

- A metropolitan area with twice the number of municipalities is associated with around 6 percent lower productivity

- Impact cut in half if there is a governance body at the metropolitan level

Source: Ahrend, Farchy, Kaplanis and Lembcke (2014)
Financing Services in Metropolitan Areas
Linking Revenues to Expenditures

- People want to see what they are getting for their taxes
- Linking taxes and services increases public support
- Examples of ballot initiatives in the US to pay for transit
Linking Revenues and Expenditures
Different services—
Different revenue tools

<table>
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<th>Public</th>
<th>Redistributive</th>
<th>Spillovers</th>
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<td>Water</td>
<td>Police</td>
<td>Social assistance</td>
<td>Roads/transit</td>
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<td>Sewers</td>
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<td>Garbage</td>
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<td>Social assistance</td>
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<tr>
<td>Transit</td>
<td>Street lights</td>
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- User fees
- Property tax
- Sales tax
- Income tax
- Intergovernmental Transfers
Different infrastructure—Different fiscal tools

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

**User fees**
- identifiable beneficiaries (transit, water)

**Borrowing**
- large scale assets with long life (roads, bridges)
Different infrastructure—Different fiscal tools

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

P3s
- large in scale; revenue stream; measurable results (toll roads)

Land value capture taxes
- increase property values (transit)
How should metropolitan services be financed?

- 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

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

- Local governments benefit from a mix of taxes:
  - Range of expenditure responsibilities
  - Services used by commuters/visitors
  - Revenues that grow with the economy (elastic)
  - Tax distortions may offset each other
  - Increase municipal flexibility in adapting to local circumstances

- Ability to set tax rates: more responsible and more accountable to taxpayers
Sources of Local Taxation, Selected OECD Countries, 2012

Final observations

- Different governance models have worked in different places at different times

- National and local context matter:
  - constitution
  - division of responsibilities and revenues
  - history of local autonomy

- Political boundaries rarely coincide with boundaries of the economic region

- Strong traditions of local autonomy make metro-wide cooperation difficult
Final observations (cont’d)

- Special districts may work where metropolitan area is too large for a political structure

- Consolidation does not necessarily reduce costs but may make it easier to levy taxes over the metropolitan area

- Need for strong regional structure that encompasses economic region; need to balance regional and local interests

- Governance and finance are linked – design effective metropolitan governance and then appropriate fiscal structure