Institutions and the Fiscal Health of Metropolitan Areas

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Introduction:

Fiscal studies over the past two decades have seen the emergence of sophisticated and broadly comparative analyses of urban finance. This area of academic work and policy recommendations was for a long time marginal, constrained by the generally restricted fiscal and administrative roles of urban areas themselves as well as a limited range of tools for study. But we are in an era marked by increasing concerns to bolster local fiscal health and foster decentralized governance. Studies of urban fiscal institutions have therefore become a true growth industry.

This paper critically examines essential urban fiscal institutions as well as comparative research on them. I argue that we see a need to come to grips with the multiplying tasks of local government, especially big cities, and that a proliferation of analytical tools is being deployed to that end. The latter include the new institutionalism, more nuanced understandings of fiscal institutions and their effects, expanded awareness of the diverse character and extent of agglomeration economies, and the deepening of the concept of the metropolitan region. Moreover, in a departure from their traditional focus on disseminating information on national-level policy innovations, the OECD and a growing number of other international organizations now produce detailed studies and benchmarks on innovative examples of urban governance and finance[1]. These studies are increasingly prominent and useful global guidelines towards the attainment of good urban fiscal health.

1) Some of these latter agencies include United Cities and Local Governments, Metropolis, and the Urban Affairs Association. Information on these and other urban-issues organizations can be found at the City Mayors site:
http://www.citymayors.com/sections/organisations_content.html

The next section turns to the background of this work, highlighting the trajectory of its most salient concerns and the forces propelling them.

Background: Decentralization and the Declining Fiscal Health of Cities

There are several reasons that urban finance is an increasingly important area of contemporary tax policy and governance studies. Certainly high on this list of reasons is the global trend towards decentralization (Armingeon: 2004). The past two decades have seen a significant shift of functional responsibilities to the municipal level in almost every country, whereas there has not been a corresponding decentralization of finances (Joumard: 2003). Nearly all cities confront an increasing weight of functional responsibilities, but many have inadequate financing to cope, let alone thrive. For many of these urban functions, such as dealing with the local fallout from ageing and income polarization as well as providing necessary amenities, underfunding can erode competitiveness. This can lead to supbar economic performance for the city itself as well as its region (Slack: 2005).

Another reason is related to the first, but is more geographically specific and somewhat more focused in its effects. The sudden emergence of the so-called transitional economies from the collapse of the Soviet Union in the early 1990s strongly influenced subnational finance and governance studies (Bird, Ebel and Wallich: 1995). Reform of the highly centralized states in these regimes was deemed to depend on both the promotion of civil society as well as the fostering of robust local government. A large number of studies, conferences and consultations have therefore focused on enhancing these countries' democratic governance and economic performance via fiscal and administrative decentralization.

Moreover, the importance of accession into the EU for many of the post-communist countries has further focused much research. The generalized framework for studies and proposals has increasingly become the EU model of local government (Denters and Rose: 2005). This model is enunciated in the European Charter of Local Self-Government, including the Charter's article 9 provisions mandating adequate financial resources and fiscal autonomy for local authorities. In practical terms, the model is also embodied by what some have referred to as the "new urban system" (Borraz and Le Gales: 2005, 16) or "new regionalism" (Newman: 2000). This model is centred on metropolitan areas and is being diffused through a proliferating network of organizations—such as METREX (the Network of European Metropolitan Regions and Areas)—and an intensive effort in benchmarking (Read: 2000).

Within the OECD countries themselves, the emphasis on decentralized governance is further strengthening. State policy is moving away from older local development models centred on transfers, regulatory protections for industrial sectors, and other top-down mechanisms. The traditional modes of support were focused on disadvantaged regions, but the new emphasis is now on policies to bolster the competitiveness of places (OECD: 2005d). These policies encourage local actors to maximize benefits from such local collective goods as natural and cultural resources, strong interfirm relations, and socioeconomic equity (Pezzini: 2003). In consequence, much policymaking is being decentralized to the local and regional levels, where the essential information and actors are. This relocation of authority further increases the importance of investigating and enhancing the fiscal health of metropolitan areas.

A closely related reason for the focus on appropriately bolstering urban finances is the continuing globalization of the economy. This fundamental transformation continues to reshape the terrain on which cities and their resident citizens and firms operate. It is now widely recognized in the urban finance and governance literature that competition is no longer primarily among urban areas in individual countries, but rather among cities and particularly metropolitan regions on an international scale (Courchene: 2005; OECD: 2002, 51)[2).

Moreover, images of economic globalization tend to centre on the fact that growth in the flows of capital and traded goods have accelerated much faster than global GDP over the past two decades. But in addition, as Harvard University Economist Richard Freeman argues, there has been an effective doubling of the global labour force (that is, workers producing for international markets) to about 3 billion workers over the past decade and a half, through the entry of Chinese, Indian, Russian and other workers into the global economy (Freeman: 2005). On the other hand, the volume of working capital has stayed virtually the same. These developments have set the stage for the "global labour arbitrage" that exploits reduced transaction costs in outsourcing low-cost labour inputs (Roach: 2006). This arbitrage is a serious challenge, but city-regions might cope well if they plan wisely, upskill their workforces, quickly ascend learning curves and otherwise act to enhance their per-

2) International cooperation among subnational actors, including big urban centres, is also increasingly notable (Fry: 2004).

formance. At the same time, this arbitrage increases the punishments that markets mete out to poorly performing cities.

Also, urban areas that provide "quality of life" amenities on top of the more basic services appear to reap significant payoffs through attracting more of the knowledge workers who are key to contemporary competitiveness (Bird: 2004; Courchene: 2005; Florida: 2005; Glaeser: 2005). These amenities include an emphasis on environmental aesthetics, hosting cultural and educational events, and affording plenty of opportunities for leisure through music, sports, parks, museums, gardens, and the like. As one recent survey of senior business executives notes, inner cities "with superior cultural and learning resources are favored over those that lack such learning resources" (Roulac, 2003). In addition, regions that alleviate income polarization and concentrations of poverty are also likely to suffer far less of the crime, health problems and other costly fallout associated with inequality. Yet simply throwing money at these challenges is poor strategy. Critical syntheses of urban studies suggest that it is essential to build and maintain competitive regions that act to ameliorate these problems. But these studies also indicate that doing this requires both adequate financing as well as good governance to ensure that the funds are used properly (Bird and Slack: 2004).

The boom in urban fiscal and governance studies centred on the developed and transitional economies is extending outwards as well. This is particularly evident in research on the world's most populous country, China, whose 668 cities are expected to grow to over 1,000 in a few years. Facing history's largest and most rapid urbanization, China's economic prospects depend to a significant extent on whether its urban finances are properly designed (Bird: 2004). And the urban challenge for the rest of the developing world is even more enormous. Note that UN Habitat's *The State of the World's Cities 2001* report projects that by 2030, 60 percent of the projected global population of 8.1 billion people will live in cities. In other words, if current population growth projections turn out to be accurate, in just over two decades there will be an additional 2 billion urban residents in the world. Fully 98 percent of these new city dwellers are likely to be resident in developing countries, where 30 percent of the aggregate population already live below the poverty line. Failure to bolster urban fiscal health in these countries risks impairing their growth prospects as well as exacerbating problems posed by pollution, the threat of epidemic disease and the like.

In short, this mix of global and local developments adds to the already difficult context that urban areas and urban policymaking confront. There is increased demand on urban services and a burgeoning need for new services related to the knowledge economy. Yet in many cases inadequate financing and excessive restrictions on fiscal options pose barriers to funding these expenditures. And sometimes even where financing is adequate, poor governance may be leading to a significant misallocation of fiscal resources. These challenges are forcing local actors and issues onto the national and international agenda, as they seek to draw attention to the mounting importance of urban needs[3]. The next section of this paper looks at how conceptual advances have been involved in the urban finance movement.

The Expanding Toolkit of Urban Studies

There has been a sophistication of analytical tools in tandem with these large-scale trends that channel attention towards urban fiscal issues. For the purposes of this paper, four tools are of especial importance.

1) The Metropolitan Region:

The concept of the metropolitan region itself is not new to studies of local governance and finance. It was introduced over seven decades ago by Roderick McKenzie (1933) in his classic work on the urban ecology of Chicago and its surrounding districts. But describing the metropolitan region has become more statistically precise as well as politically important in recent years. In OECD Territorial Studies (eg, OECD: 2004b, 87-98) and similar literature, the metropolitan region is defined by the commuting flows that compose labour markets as well as other quantifiable socioeconomic features of cities.

This is not to suggest that there is as yet anything approaching a consensus concerning what to do with the metropolitan region. In fact, there has long been a polarized debate on what generalized framework of governance and fiscal institutions is appropriate for any given metropolitan region. To simplify the essence of the debate, one side of the argument holds that there are numerous payoffs to be gained by trying to equalize fiscal burdens and service provision throughout the larger urban re-

3) For example, May 5, 2004 saw the launch of United Cities and Local Governments, a new international organization composed of three large and previously existing international organizations: International Union of Local Authorities (IULA), the World Federation of United Cities (FMCU) and Metropolis, an organization representing 84 global cities.

gion. Many students of urban finance and governance advocate metropolitan government, particularly through a coherent and region-wide regime of fiscal and political institutions. They suggest that the payoffs from such reform can include reduced incentives for cities in the region to compete for businesses through extending tax breaks and subsidies, alleviation of concentrations of poverty and poor services, and so forth.

By contrast, opposing views hold that it is better to allow more fragmented administrative units to compete for residents, business and tax bases within the region. Smaller units of government are seen as more accountable to the wishes of local residents and thus more efficient in their operations. Where necessary, this perspective suggests, specific urban functions can be coordinated at the regional level via agreements among local municipalities or through the agency of higher levels of the state (CBASSE: 1999).

Among the new studies advancing this debate are nuanced, empirical research findings on different regions. The research suggests that more centralized, metropolitan structures of finance and governance are better able to deal with such socioeconomic challenges as development, inequality and the like (Miller: 2002). Other work indicates that metropolitan organization enhances accountability, and even citizen satisfaction. It also argues that leaving overall orchestration of interactions among regional actors to the central government entails transaction costs, conflicts of interest, and the potential distortion of preferences (Lowery: 2002). And all of these issues assume a greater than usual significance because of the increasing salience of the global context and the myriad ways in which it drives regional competitiveness to the fore of the policymaking agenda. The growing consensus on the need for strategies to bolster the fiscal health and coherence of metropolitan regions is reflected in the proliferating research as well as in the work of such institutions as the EU and its Committee of the Regions (van den Berg, Braun and van der Meer: 2004).

2) *Functional and Administrative Regions:*

These concepts are especially salient within the OECD's territorial typologies (Pezzini: 2003), as well as elsewhere (Lysgard: 1997), and are essential tools for studying the political and economic aspects of the metropolitan region. Administrative regions are defined by the extant urban boundaries as well as the jurisdictions of the separate agencies that are often—particularly in the United States—in charge of transportation and other functions. The borders of administrative institutions thus demarcate the boundaries of administrative responsibilities. The main concern for good urban governance and fiscal health is that these boundaries are often poorly matched to the constantly evolving economic relationships within and among the territorial units. The concept of the functional region therefore looks beyond the administrative boundaries to elucidate areas that have more internal interaction—as in commuting flows—than interaction with outside areas. Once the functional regions have thus been defined, they are compared to their administrative counterparts. This comparison allows research to determine how well the economic relationships within the functional regions correspond to the oversight and coordination provided by the administrative regions. Generally, the object of such study and subsequent policy recommendations is to find mechanisms to improve the fit between administrative and functional regions. There can never be a perfect fit, of course, since functional regions constantly evolve. But achieving a closer match through developing new administrative institutions or revising the roles or reach of established ones can help to allow finance, planning, and other important metropolitan tasks be undertaken more efficiently and effectively.

3) *Agglomeration Economies:*

The literature on these economies and their relationship to urbanization dates back over a century. The economist Alfred Marshall (1842-1924) first noted that clustering of businesses leads to knowledge spillovers[4], advantages of thick markets for specialized skills[5], and backward and forward linkages from large local markets (Fujita, Krugman, Venables: 2001). Marshallian agglomeration economies are, in other words, the advantages gained by firms in the same industry when they gather in the same location. Firms clustered together in a region can generally purchase their main inputs—especially labour—at lower costs (especially transaction costs) and with more flexibility in supply.

A second category of the economies gained from clustering is called Jacobian agglomeration economies (Glaeser: 2000). These are the advantages that derive from

4) A knowledge spillover refers to the spread of useful information where the source is not compensated for it. In other words, a spillover is not a business transaction.

5) A “thick market” means there is a high proportion of potential employees, customers and the like in the overall population.

having firms in different industries gathered in the same metropolitan area. Jacobian agglomeration economies largely derive from "face-to-face" interactions, wherein information and ideas are exchanged, often as a matter of chance rather than design. Examples from the process of production include opportunities that arise in research and deal-making. Interaction opportunities also frequently arise in the consumption of such regional services as education, health care, live entertainment and dining (Inman: 2003).

The important point for our purposes here is that these interactions contribute enormously to regional economic vitality and can reduce the costs (while raising the quality) of locally produced services to all residents. But at the same time, these interactions occur with greatest frequency and efficiency in major cities (Rosenthal and Strange: 2004). The forecast "death of geography" through globalization and information technology appears, at the very least, to have been exaggerated with respect to creative and innovative work, where actors' physical proximity is a key factor (Morgan: 2004). Moreover, because the returns from agglomeration economies bolster the regional economy as a whole, there appears to be a powerful equity argument for concentrating public investment in cities rather than emphasizing redistribution to rural areas (Brown et al: 2005). Indeed, in fiscal terms it may even be cost-effective for suburban residents to shoulder a portion of the burden of financing the central city (Haughwout and Inman: 2004).

4) Fiscal Health:

There is a massive and expanding literature on fiscal health that can be separated into restrictive and expansive conceptions of it. Both of these approaches are being encouraged by the general background of decentralization and the related increase in demands on local government. However, the restrictive approaches generally focus on balancing the books of local governments rather than more broadly examining the appropriate role of the local public sector in the vitality of the local economy. One application—known as the "local revenue hills" approach—deploys the Laffer Curve in the study of city finances. It therefore looks to tax cuts as a means to keep existing residents (both people and businesses) and potentially attract more. These studies suggest that the disincentive effects of urban taxes are very powerful, so that cutting them can lead to a much more vibrant local economy and compensate for the reduced scope and scale of services delivered by the local public sector (Haughwout, et al: 2003).

The more expansive understandings of fiscal health offer, in general, a sharp contrast. These latter researches do not deny the importance of fiscal discipline or the incentive effects of taxation, but they incorporate these features into a larger framework that takes note of the evolving roles of the public sector and policies for competitiveness. Many studies advance the premise (either implicitly or explicitly) that the local public sector is often called upon to do more in order to foster competitiveness and in turn a more robust tax base. They also stress that we need comprehensive analyses of a given urban area's expenditure needs and its capacity to raise revenues. Some of these analysts therefore argue, for example, that bankruptcy of an urban government is not necessarily a defining indicator of its fiscal health. For the restrictive conception of fiscal health, on the other hand, bankruptcy of an urban administration would be read as prima facie evidence of poor fiscal health[6].

Thus, along with the expanded notions of fiscal health go emphases on the expanded set of amenities that cities find themselves called upon to provide. These amenities are said to bolster the agglomeration economies in metropolitan regions, and are deemed key to enhancing competitiveness in a globalizing era. It is striking how frequently the recent comparative literature on urban finance strategies refers to the need to provide what might be summarized as the "knowledge economy infrastructure" as well as other amenities critical to a good quality of life and thus attractive for potentially resident employees and employers in the knowledge economy (Bird: 2004; Courchene: 2005; Glaeser: 2005; Slack, Bourne, and Gertler: 2003), The next section turns to consider in detail a recent treatment of fiscal health.

Expanding Ideas on Metropolitan Fiscal Health

An expanded concept of fiscal health can be seen in the work of Reschovsky and Chernick (2004). Their studies of urban finance stretch back over two decades, for the most part delineating the relationship between state and municipal fiscal institutions and socioeconomic outcomes. More recently, much of their research has focused in particular on the metropolitan area and how to measure the "fiscal health" of its constituent cities and suburbs. In spite of the growth in studies of urban finance, particularly case studies of individual cities, they point out that "there has been almost

6) A useful summary of different approaches in fiscal health can be found in chapter 2 "Fiscal Health Literature: Drifts and Reflections," in Hondale, Costa, and Cigler: 2004. 17-37.

no systematic research that has attempted to identify the set of factors that are most likely to contribute to fiscally and economically successful urban areas.” Their route through the thicket of urban diversity and towards consistent principles is via a detailed investigation of urban fiscal health.

Fiscal health, in their account, is a matter that goes well beyond simply seeking to balance the books of urban administrations. Not providing certain services, notably those that alleviate concentration of low-income populations, can increase the costs of other services such as education and public safety. It can also hinder the potential for economic growth and thus weaken the local tax base. Hence, they point to the gap between expenditure needs and revenue-raising capacity as a more accurate indicator of fiscal health. They argue that extensive surveys of urban fiscal institutions are needed in order to make consistent comparisons as well as recommendations for reforms.

Revenue-Raising Capacity

For Chernick and Reschovsky, revenue-raising capacity is a measure of how much funding a given jurisdiction can raise. Generally, they see it as a function of the local tax mix as well as the level of economic activity in the particular jurisdiction. As yet, no single approach in this respect has gained predominance among analysts. The standard measure of fiscal capacity, variants of which are used in calculations for many equalization systems, is to construct a “representative tax system.” This system is usually based on using the averages of all the tax rates of all the taxes in a given metropolitan region, provincial jurisdiction, or nation. Yet the resulting measures of revenue-raising capacity have little connection to the broader economic base of the jurisdiction in question. An alternative approach to fiscal capacity would be essentially to ignore the matter of which taxes are levied and instead estimate capacity from the sheer size of the economy. Yet this approach is equally unrealistic. This is because no matter the size of the economic base, achieving anything approaching full exploitation of it would require a broad mix of taxes. Moreover, omitting taxes from consideration neglects a core issue for urban finance, which is the effect that particular taxes have on fiscal capacity through their revenue-raising power as well as their influence on economic behaviour. Chernick and Reschovsky thus sketch a fiscal capacity framework that remains alert to the interactions between taxes and the economy. They note that “[t]he greater the elasticity of the tax base with respect to its rate, the less a city or municipality should rely on that base.” Monitoring the performance of a given tax can be done through observing the volume of revenues accrued through it as well as looking for indications that it is interfering with locational and other economic decisions. One very useful means for testing the effect of a given tax is when a surtax is implemented, as in response to a budgetary shortfall. Poor revenue performance in this case might be a sign that reliance on the tax per se needs to be reduced.

The Expenditure Side

Among the OECD countries, diversity of local governments' expenditure regimes likely exceeds even the enormous variation among their revenue structures. The stereotype of local spending focuses on basic infrastructures, such as water and sewerage, as well as such essential services as public safety and fire control. Yet in practice there is much greater variation. This diversity has a multiplicity of causes, including the degree of decentralization in the particular country or province and the influence of demographic factors.

Chernick and Reschovsky advance a useful way to begin imposing some analytical order on municipal expenditure patterns. They suggest that we can look at the assignment of functions in a given case as belonging to one of the following three categories: minimal, intermediate and maximal. In their schema, a minimal assignment of municipal functions would include local police, fire protection, parks, emergency services, water supply, property regulation, local environmental conditions, garbage disposal, and several basic services for the neediest of local residents. These latter would include medical clinics, child welfare services, as well as shelters and other services for the homeless. Examples of the minimal assignment of functions can be found in the US city of Milwaukee. Fragmentation of local functions appears to be largely responsible for the city's minimalist set of services. For one thing, the city is not responsible for education since there is an independent school district. Nor is Milwaukee responsible for much in the way of social services, as these are county government functions. The county government is also assigned numerous recreation and cultural functions. Some Canadian cities would also fit in this minimal category, especially those where the provincial governments have recentralized control over compulsory education.

An intermediate assignment of functions would include the above as well as the assignment of elementary and secondary education, communicable disease control, and others. An example of a city that would fit in this category is Tokyo, Japan.

The maximal assignment of functions is distinguished by the inclusion of expenditure categories that have substantial redistributive effects. Expenditures of this type are income transfers, health care and housing. Cities that fit into this maximal category can be found clustered in the Scandinavian countries, with Stockholm, Sweden being a prominent example. Sweden effectively lacks a provincial or similar mid-tier level of government. This minimalism at the mid-tier level gives Sweden an "hourglass" structure of governance, one that sees many ordinarily mid-tier functions in the hands of the cities.

These three categories can be further broken down by examining three aspects of the assignment of functions: service provision; financing; and accountability, monitoring and policy control. The combination of these aspects in a particular case denotes whether the local government dominates or whether higher-level governments do. A number of analytical implications stem from the results. To take one example, a high degree of local service provision may not be matched by a high degree of local financing and policy control. In most cases, this lack of subsidiarity in control of the purse and the design of projects leads to mismatches between local needs and the pattern of services that is in fact provided. Knowing this, the researcher is well-advised to look for evidence of wasteful and ineffective expenditures. Similarly, a low or only moderate degree of upper-tier financing coupled with a great deal of upper-tier monitoring and control is likely to lead to unfunded mandates. In intergovernmental relations, unfunded mandates are rules, enacted by an upper-tier government, that require a lower level of government to perform certain tasks but come with no financing to cover the cost. Such mandates are often regarded as a particular problem in the United States (Nivola: 2003), but are also seen for example in Sweden. In the latter country, the central government mandates detailed rules concerning education at the local level, but extends very little financing to cover the costs engendered in complying with the rules.

Minding the Gaps

With these analytical tools, we are better equipped to study the conditions of a given urban administration's finances and make recommendations for improving them. The standard approach to fiscal health can also come into play here, generally taking as given the structure of taxes and expenditures while making marginal adjustments in order to balance the books. And yet, as Chernick and Reschovsky also emphasize, this local gap between revenues and expenditures is not the only one we ought to be concerned with.

A further important dimension of urban finance is found at the level of the metropolitan region. Any metropolitan region is composed of several constituent cities, and these cities will inevitably enjoy different levels of economic activity. In consequence, they will also have differing fiscal capacities, and often quite wide variance in this respect. The question is what to about this regional fiscal gap.

The simple model of fiscal health would suggest that the regional fiscal gap, or horizontal imbalance, is not a serious problem and that attempting to rectify it would almost certainly exacerbate it. In this model, cities and communities compete with each other in a Tieboutian universe, where the movement of residents and local businesses is determined by their preferences. These preferences, in turn, dictate the tax and expenditure mix. The concern here is to promote as much fiscal efficiency as possible through competition as well as bottom-up democratic mechanisms that shape and monitor the tax and spending mix at the local level. Regional fiscal health in this view is best achieved through leaving the management of area cities' revenues and spending in the hands of their respective managers and voters.

But this public-choice model has serious shortcomings (Krane, et al.: 2004, 518–19). One especially significant problem insofar as fiscal health is concerned is that the model is so heavily predicated on fostering competition among administrations in the same geographical area. Competition for growth has turned regional and global, and the scope of local responsibility is expanding as well. The existence of spillovers and externalities see individual communities, if left to their own devices, inclined to underspend on services and infrastructures that are important at the regional level. Relatedly, communities also have significant incentives to exclude low-income and minority members. This strategy has an economistic rationality at the individual community level but not at the regional level. Seen from the latter perspective, the fact that concentrations of poverty and its attendant social ills generally cluster in the central city is a particular problem. This is because a poorly functioning central city can impair the Marshallian and Jacobean agglomeration economies that are essential to fostering urban and regional economic competitiveness.

As Chernick and Reschovsky explain, fiscal gaps across the communities that comprise a metropolitan region tend to lead to out-migration. This phenomenon is seen when firms and individuals with the means to do so relocate—often to the suburbs—in order to escape declining circumstances and the increasing fiscal burdens imposed to cope with the costs. This migration in turn creates fiscal externalities that encourage more migration. The result is “cumulative deterioration” of urban areas and particularly of the central cities. We observe these phenomena throughout the world, in “a whole set of urban ills—physical deterioration, aged infrastructure, high crime, homelessness, and continued loss of population and economic base.” These effects raise costs in the central city, which only encourages further flight. The deconcentration of firms in the metropolitan area may also undermine the area’s growth potential through eroding the agglomeration economies.

In other words, the emphasis on promoting fiscal and related competition among area municipalities can lead to declining property values, increasing costs for locally produced goods and services, and in general an erosion of the quality of life in the community. An efficiently and effectively functioning central city should be producing a wide variety of specialized services for its region, keeping costs down for local residents and businesses. Given these risks, it would appear best to examine the challenges and possible institutional responses in order to generate better ideas on the range of fiscal options that suit particular circumstances. Simply allowing outcomes to be decided by the political process, without investigating options (and tradeoffs inherent in options) is unwise. Inadequate information can lead to failure of political markets just as it can with economic markets. Since subpar performance in central cities has been to show to cost the entire region, policy options are best discussed in regional terms.

The next section turns to the diversity of local fiscal regimes and some of the frequently benchmarked institutional reforms that have been attempted or installed in recent years.

The Empirical Reality of Local and Metropolitan Finance

In practice, the tax systems of urban governments present a great challenge to any effort to summarize them. Not only are there hundreds of large cities (if we restrict our focus only to, say, urban centres of over a million residents), but their fiscal regimes vary in ways that make much beyond the most superficial generalizations almost impossible. Even within the same country, there is often enormous diversity. For example, a 2000 study by the New York City Independent Budget Office compared the tax efforts and structures of America’s ten most populous cities, including New York, Los Angeles, Chicago, Houston, Philadelphia, San Diego, Phoenix, San Antonio, Dallas and Detroit. The study found that—as a percent of total taxes—property taxes (in 1997) varied from a low 37.5 percent in New York to a high of 77.6 percent in San

Antonio, Texas. By contrast, taxes on business income were highest in New York at 16.4 percent whereas Chicago and Phoenix had none and San Antonio only collected 1.7 percent of its revenue from them (NYCIBO, 2000: 9).

The local tax systems of other OECD countries have rather less variation. In unitary states, if fact, there is a strong tendency to have a relatively uniform set of taxes for local governments. Yet even in these cases, there is often some variation, particularly through affording to larger urban governments a more diverse set of taxes and more autonomy to adjust their rates and bases. In Korea, for example, the tax mix at the local level varies with the administration. The capital city, Seoul, and other big urban centres (referred to as "metropolitan cities") are assigned a complex of 13 taxes while smaller local governments have more restricted tax bases (OECD: 2005, 126).

As a general rule, a given municipal tax structure is heavily influenced by the role that the local government is assigned in the overall public sector. Drawing on the urban function framework suggested by Chernick and Reschovsky, it seems clear that the more extensive the role of the local government, the more its revenue base is shifted away from reliance on property. Consider New York, which is the only large American city that has to carry a major share of the costs of welfare and medical assistance. In other American states, these costs are divided between the state and the federal government. New York state, however, requires its local administrations to cover half of the costs that are not covered by the federal government. The 2000 study of America's 10 largest cities' tax systems by the New York City Independent Budget Office (NYCIBO, 2000: 9) determined that these costs "accounted for more than half of the overall difference in tax effort between New York City and the other large cities." It also showed that the city had the most diverse revenue structure, with over a third of its own-source revenues from taxes on personal and business income.

But a large scale and scope of functions does not always lead to revenue diversity. This is evident in the case of Stockholm, which certainly can be said to shoulder a maximal assignment of functions. The city provides such services as schooling, health care, social assistance and other social services. As the OECD (2001, 98-9) points out, these are costly services and have strong equity implications. This maximal assignment is, moreover, true of Swedish cities in general. Yet Swedish cities are financed, so far as taxes are concerned, through a local income tax only. But the average rate of this local income tax was not the few percentage points common in American cities. In 2003, the overall burden of Sweden's local income tax totaled 16.5 percent of GDP

(OECD: 2005a) and funded on average, about 60 percent of Swedish cities' overall expenditures.

There is thus much divergence there is among big urban governments, both on the revenue and spending sides. It is important to keep this diversity in mind, but at the same time it is perhaps just as important to note that city regions throughout the OECD face several common challenges through decentralization, globalization, income polarization, and the other factors noted earlier. These common challenges are one main reason that benchmarking is possible and required in spite of the diversity of urban fiscal institutions in practice. Watching the relative successes of city regions in maintaining their fiscal health provides potentially valuable comparative lessons. For example, as to revenues, Sweden's urban finance is centred on the income tax whereas Canadian urban finance is centred on the property tax. Because all taxes have several merits and demerits associated with them, the broad tax mix evident in Tokyo is perhaps an advantage when it comes to maintaining fiscal health. The next section discusses these fiscal institutions and their effects in greater detail.

Benchmarking for Healthier Metropolitan Governance:

The Problem of Unbalanced Revenue Systems

Unbalanced revenue systems are a common hindrance to achieving fiscal health in metropolitan areas and big cities. As noted earlier, local governments in many countries are heavily reliant on one tax, whether that be the property tax, income tax, or business tax (Caufield: 1997). Even countries that are nominally quite decentralized are marked by this problem. A striking case in this respect is seen in Canadian cities, which are limited almost exclusively to using the property tax for revenues[7]. One result is that even though the largest of the Canadian metropolises—Toronto, Montreal and Vancouver—generate close to half of their respective province's GDP, they have insufficient financing (OECD: 2002). Though this issue has long been mulled over by specialists, it became a very significant nationwide debate from the late 1990s. This was because extensive downsizing of the central government and offloading of many fiscal burdens to the provinces and then to the municipalities came in a period when

7) Chernick and Reschovsky (2005) cite an April 8, 2004 memo from Canadian tax specialist Harry Kitchen to the effect that Canadian municipalities rely on the property tax for 62.3 percent of their revenues overall and 97 percent of their total tax revenues.

the significance of cities and their services was rapidly increasing.

Being creatures of the provincial governments, and largely lacking the charters common for cities elsewhere, Canadian municipalities are highly constrained by the provincial authorities (OECD: 2004, 105). In particular, Canadian cities have virtually no power to implement new taxes. The city of Toronto, for example, has sought for years to implement a hotel tax, and even won over the support from the hotel owners association (Moloney, 2002). But the provincial government will not allow the tax. This is in spite of the argument that the revenues would fund tourism-related services, such as information services and promotion via advertisements. Such levies are a common and reasonable means for funding the advertising essential for attracting tourists. Certainly the tax exports a burden onto non-residents. But because the services it funds are designed for those non-residents, it is generally considered to be equitable and to avoid the usual moral hazards attendant with exporting tax burdens (Slack: 2005).

Because Canadian urban finance is perhaps the most noticeable OECD example of unbalanced revenues, it is worth examining the problem and proposed solutions in more detail. The key to resolving Canada's urban fiscal crisis is increased revenues through a more balanced revenue structure. Virtually all interested parties in the public debate on the crisis agree that the property tax is simply inadequate to finance cities' current and future needs. For example, the OECD's 2002 Territorial Review of Canada observed that persuasive evidence indicates Canadian cities require at least CAD 9.2 billion of infrastructure investment in the 5 years span to 2007. The report further pointed out that "municipal income taxes, visitor or commuter taxes and sales taxes are quite frequent in the US, and some form of local income tax exists in approximately half of OECD member countries," and that Canadian cities ought to "be given some limited access to other types of taxes" rather than merely the property tax (OECD: 2002, 193-4). In addition, the OECD review of metropolitan Montreal agreed that reliance on the property tax is leading to an underfunding of urban infrastructure. The review added that reliance on the property tax also means that non-resident commuters contribute little to fund services provided by the city and that there is a weak link between tax revenues and growth of the metropolitan economy. This latter fact could pose a disincentive to local development efforts, unless there were powerful compensating motivations for city officials (OECD: 2004b, 110).

For these reasons, Canada's public debate centres on a "new deal" for the cities. In the first half of this decade, the definition of the new deal came to mean getting more autonomy and revenue-raising power from the senior levels of government. The aim of the new deal was to provide cities with the capacity to attend to the challenges that confront them.

But throughout the attentive policy community in Canada, perhaps the best known and most highly regarded definition of the new deal remains that advocated by the city of Winnipeg in 2003. Winnipeg is a city of 675,000 in the Canadian province of Manitoba, and a typical example of a city whose fiscal health is suffering. It cut its spending by 9 percent between 1994 and 2003, due largely to enforced fiscal austerity from the provincial and federal administrations' cuts in transfers. It has also, like other Canadian cites, had to cope with the costs of offloaded responsibilities. But its property-tax centred revenue base has offered very little room for covering those costs as well as increasing spending on the infrastructural and other essential programmes.

Not only is Winnipeg's reliance on the property tax very high; its revenues from the tax declined by 15% (adjusted for inflation) between 1994 and 2002 and there was virtually no increase in property values over the same period. There is not likely to be much increase without a significant improvement in the city's economic fortunes, which appears unlikely without essential public investments. Winnipeg's also shares the challenge confronted by many other North American cities, in that the city centre is not growing but the suburbs are. This sprawl leads to an erosion of the urban a rea's revenue base as well as its economic prospects, since it erodes the agglomeration economies that are key to urban competitiveness.

In place of merely advocating more borrowing or raising existing taxes, the city administration proposed what the OECD regards as an "innovative and original" new deal tax reform in the fall of 2003 (OECD: 2004b, 114–15). The new deal proposed to eliminate of Winnipeg's business tax and halve the revenues from the city's property tax. In place of these revenues, the city sought a "tax shift" towards a revenue structure that is more closely linked to the services it is to finance. New taxes were to include a 1% city sales tax, a 5 cent per litre charge on gasoline sales, a city hotel tax, a telephone fee, and various environmental fees (including a garbage-bag fee). Moreover, in place of the current provincial transfers, the reform proposed that the province earmark 1/2 percent of the 7% provincial sales tax and a portion of the provincial income tax paid by Winnipeg residents as a bloc grant. The reform was to be revenue-neutral for the province, but for urban residents it would enhance accountability and the visibility of revenue sources as well as the expenditures they fund. In short, it was an innovative approach based on the benefit principle.

Though Winnipeg was seeking additional revenues, primarily for funding infrastructure investments, this does not wholly explain the widespread appeal of the reform package. Another aspect of the plan's appeal was its emphasis on the environment. Indeed, the overriding goal of the tax shift itself is to encourage environmentally sustainable choices among urban residents, and was modeled on the long Scandinavian experience with environmental taxation (Lundqvist, 2000: 5). The reform proposed higher natural gas and electricity charges. At present, these charges are set at 2.5–5% on non-heating consumption only, but the proposed shift would have seen a 7% charge on all consumption. The charge increases were to encourage conservation as well as fund improved transit (with transit fares to be halved), public-building environmental retrofits, and expanded park services. Also a liquor tax of 7% would be used to finance police response, with the rationale being that many incidents are alcohol-related.

Innovative as it was, the New Deal failed to gain the trust of urban residents. Many doubted that the tax shift would not result in a permanent shift to a new tax structure, fearing that the reductions in the property tax would be followed by increases later on. In addition, the new city sales tax required provincial approval, and that was not forthcoming (Reid: 2004). Hence, a new package of reforms was proposed in the spring of 2004. This second effort drastically simplified the initial plan by proposing a 4% cut in property taxes for a trade-off of a new fuel tax plus 2/3 of 1% of the provincial Goods and Service Tax and 6 cents of the tax collected on every litre of gasoline purchased in Winnipeg via the existing fuel tax.

In the event, Winnipeg failed to secure provincial agreement on new taxes and/or tax sharing. This failure was generalized throughout the country, and saw Canadian cities compelled to accept increased transfers instead. This was evident when the Canadian federal government, in its 2005–06 budget, put through a "new deal for cities and communities." The Federal government has committed itself to rebating 1.5 cents of the 10 cents per litre of revenues it collects from the gasoline tax. In the 2005 fiscal year, this new transfer was deemed to amount to CAN $600 million in new financing for all local governments. Moreover, the Federal Government committed itself to raising this transfer to 5 cents per litre (totaling CAN $2 billion) over 5 years, achieving that level in the 2009 fiscal year. The previous year's budget had also included a commitment to transferring rebates of the Federal Goods and Services Tax to local governments. In total, this transfer is projected to amount to CAN $7 billion over 10 years. Additional funds are being made available through various infrastructure-related programmes such as accelerating the CAN $1 billion Municipal Rural Infrastructure Fund from a 10-year to a five-year programme. The bulk of these transfers are disbursed through the provincial levels of government and are targeted in particular at such "environmentally sustainable municipal infrastructure" as public transit, water services, wastewater treatment, and community energy systems.

From the perspective of shoring up urban fiscal health, however, this temporary solution to the Canadian cities' financing problem appears far from ideal. For one thing, where extra revenues are deemed essential, the expansion of own-source revenues ought to be emphasized rather than increased reliance on transfers. Transfers are not only subject to cutbacks when senior levels of government experience fiscal difficulties; they also do little to enhance the fiscal discipline of urban governments (OECD: 2005c). Moreover, transfers based on gasoline tax revenues are problematic because forecast growth in these revenues from 2008 to 2025 is a meager 1.6% per year (Conference Board of Canada: 2005). An additional set of problems arises when senior levels of government determine how the transfers are to be spent. At times, such direct targeting of transfers is necessary in order to enforce local fiscal discipline as well as ensure that the funds are used where dealing with significant externalities or spillovers is the aim. Yet centralized control over transfers brings with it the risk that diverse local needs will be ignored in favour of the organizational interests of the governing parties and bureaucratic authorities in the upper levels of government. While financing urban infrastructure is clearly a pressing need in the Canadian case, that may not be the major challenge a few years hence. Financing from own revenues rather than earmarked transfers ensures that there is the flexibility to shift finances to other purposes as the need arises and without having to enter into potentially time-consuming negotiations with senior levels of government.

Revenue Imbalances Elsewhere

As noted, the problem of municipal revenue imbalances is evident in other countries, though generally to a less debilitating extent than in Canada. Complete, or at least heavy, reliance on a single tax base does not necessarily impair fiscal health so much that the capacity to provide essential infrastructure and services is undermined. But such dependence can result in unpredictable local revenue streams, especially if the tax is sensitive to economic cycles. The dependence can also influence an urban administration's economic policymaking choices.

Swedish local governments rely on a flat income tax for all of their tax revenues. The income tax has the benefit of providing a buoyant revenue base, especially at the comparatively high rates (varying from 29 to 34 percent in 2004) levied by Swedish local governments. Yet there are also risks of revenue instability as well as skewed development incentives from an income-tax centred system. In Stockholm, for example, the municipal authorities are apparently disinclined to invest in upgrading the infrastructure for conveniently located Bromma Airport. Seen from a business-management perspective, investment in the airport would not bring in much new revenue via the income tax. For this reason, the OECD territorial review of Stockholm recommended that a portion of the national property-tax regime be decentralized. The report argued that shifting some of the property tax to the local level would help to reduce fluctuations in local revenues as well as balance local economic development decisions (OECD: 2005b).

Sprawl and the Depletion of Inner Cities

Suburban sprawl and the attendant depletion of inner cities is also increasingly viewed as a problem throughout the OECD countries (ECMT-OECD, 2000). Sprawl is evident in all OECD countries and contributes to income polarization, the erosion of agglomeration economies, pollution, excessive energy consumption (through commuting) and other problems. But the phenomenon appears to be most notable and pose the most difficult problems in the United States. As factors encouraging sprawl, many experts on American urban issues highlight the shrinking tax base of American cities through the movement of the middle class to the suburbs and the fact that state aid and state tax policies "favor suburban communities, making it relatively more difficult for cities to afford basic services for their residents" (Chernick and Reschovsky, 2001).

Other analysts suggest that the challenges are exacerbated by the fact that the taxes of America's local, state and federal governments generally weigh more heavily on savings rather than consumption, the opposite of the case in most other OECD countries. A comparative study by the Brookings Institute suggests that the effect of very low gasoline taxes, low sales taxes on vehicles works in tandem with other public policies (including comparatively poor investment in mass transit) to encourage suburban sprawl and its accompanying highly wasteful forms of consumption (Nivola, 1999). There is also a great deal of specialist discussion of the harmful environmental and health effects of this sprawl and the failure to reflect these negative externalities in fuel prices (Marshall, 2001). Yet controlling suburban sprawl would require a number of politically difficult reforms, including perhaps green tax reforms. In part because of this, there are only a few examples—such as Portland Oregon—where urban development has been deliberately and successfully controlled[8].

A recent study of the costs of sprawl in the United States concluded that it imposes major costs via increasing expenditures for new water and sewer hookups by 20% to 40% as well as requiring longer roadways and more outlays for policing, fire, education and other services. The study's authors concluded that sprawl imposed pecuniary costs of US $31 billion annually (Burchell, Downs, McCann and Mukerji: 2005). The fiscal effects of suburban sprawl are also a focus of increasing debate, as residents left behind in the inner cities have markedly lower incomes, education levels and even health than residents in the suburbs (Frumkin: 2002). Another result of this widening geographical separation of the income classes and their consumption is that the inner cities gradually lose their economic vitality. Property values decline, depressing revenues from the property tax. Reduced economic activity also erodes the revenues from local taxes on income and consumption, if they exist. These developments further undermine an important element of the local tax base.

American cities have access to an increasingly wide range of tax options (Krane, et al: 2004). But many fiscal analysts view the decline of the property tax—from 65 percent of total local revenue in previous decades to merely 25 percent in recent years—in the US local tax base as a negative development. This is because a host of exemptions, abatements and equity provisions have seriously eroded the base of the tax (Murray: 2003). These development are said to have undermined local fiscal autonomy and further skewed urban development policies (Brunori: 2003).

The declining role of the property tax in US local finance seems in fact to be driven less by inevitable socio-economic change or urban managers' strategic choice

8) On Portland's unique—in the American context—history of land-use planning, see http://www.metro-region.org/ and Box 3.2 in OECD (2005b).

than it is by political necessity. This is because the American regime of fiscal politics remains heavily influenced by the legacy of Proposition 13, which spread throughout the country.

Proposition 13 was the 1978 voter-supported ballot initiative that cut property taxes in California by half. The general effect of the spread of these initiatives on local revenue systems was a shift from property taxes to a profusion of user charges. For urban areas, however, there was a pronounced shift to increased reliance on the sales tax and local income taxes. And even as this trend emerged, the comparatively narrow base of sales taxation in the US (services are excluded) grew narrower as lobbying brought an increasing number of exemptions (Tannenwald: 2001).

A striking consequence of this kind of fiscal regime is its effect in encouraging zoning decisions that add to the movement to the suburbs. Dependence on the narrowly-based sales tax in particular sees cities seek to increase revenues by favouring zoning that attracts shopping malls and so-called “big-box” retailers as opposed to housing or office parks. These large retail businesses tend, however, to favour location in the suburbs, and their price competitiveness (from lower rents, greater economies of scale, and the like) then drives inner-city small supermarkets and corner shops into bankruptcy. This of course further saps the vitality of inner-city businesses, further weakening the tax base, and hence the local administration’s ability to provide public services. This vicious cycle then increases the incentives of middle—and upper-income earners to move out of the city and into the suburbs, leaving behind a higher proportion of poorer people with great needs for services and assistance but inadequate resources to cover the tax cost of them.

Along with growing polarization of incomes in the marketplace, these fiscal trends contribute to the spatial polarization of incomes. In turn, this increases the inner-city demand for such public services as health care and policing. As is well known, crime rates increase with increasing income polarization (Daly, Wilson, and Vazdev: 2001; Lee: 2002), and the costs of police, prisons and related expenditures place enormous burdens on local governments. Moreover, concentrated poverty has been shown to degrade the fiscal health of cities on the expenditure side by increasing spending on antipoverty programs and policing as well as significantly raising the cost of providing even such services as fire protection and other general government functions (Joassart-Marcelli, Musso and Wolch: 2005). An emergent literature has also begun to highlight surprising correlations between income inequality and higher rates of disease and mortality (Feng and Myles: 2005; Quebec, D. o. H. a. S. S.: 2003). To the extent that the related services are provided locally, the direct expenditure costs will again be elevated by concentrations of low-income residents.

In short, even where the tax base is not dominated by undue reliance on a particular tax, it can be undermined by the political economy of sprawl. The next section considers some mechanisms that can help alleviate these problems.

Tax-Sharing and other Fiscal Institutions

One important way to alleviate the socioeconomic fallout from the disparities discussed above is tax-revenue sharing within the metropolitan region. Revenue sharing is also often suggested as a means to overcome wasteful competition for business as well as for residents who pay more than they use in services, both of which can lead to sprawl (McGuire and Sjoquist, 2003). There is a wide variety of revenue-sharing mechanisms in place among the OECD countries. The generally more centralized systems of the unitary states often have strong metropolitan governance with explicit mechanisms for fiscal redistribution incorporated within it. By contrast, the generally more decentralized systems of the federal states tend to lack defined redistributive mechanisms. They either do not redistribute at the metropolitan level, or they have instead evolved simpler and more fiscally restricted means than are generally found in the centralized systems[9] (Thomas: 2002).

Metropolitan Fiscal Equalization in Tokyo

One of the world's largest and most highly developed local tax-sharing systems is found in the Tokyo metropolitan region. Known as the "metropolitan-ward fiscal equalization system," Tokyo's tax-sharing scheme redistributed YEN 1.48 trillion in 2003. Among Japan's 13 metropolitan cities, Tokyo is the only one with an explicit intra-metropolitan revenue-sharing arrangement. This is because the other cities are consolidated, metropolitan-wide administrations without autonomous cities within their jurisdictions. Tokyo, on the other hand, is composed of 23 special wards, or "tokubetsu-

9) Note, however, that the imposition of payroll taxes on non-resident labour by municipalities within a metropolitan area can give rise to "implicit tax base sharing." Workers pay to the communities in which they work rather than the ones in which they reside, resulting in an effective transfer to the former and from the latter. Such taxes are fairly common in the United States, with 12 states permitting their use by local governments (Anderson, 2002).

ku," which are roughly equivalent to cities in their fiscal and administrative powers. Unlike wards in other Japanese cities, Tokyo's special wards have their own elected mayors and councils. Tokyo's institution of intergovernmental redistribution at the national level during the Second World War was followed right after the 1945 surrender with the 1947 creation of elected ku leadership and a tax-sharing arrangement. This tax-sharing arrangement went through many reforms afterwards, and was at one point a simple disbursement from the metropolitan treasury. Indeed, the system was not fully systematized until 1975.

The scale of the current equalization system is quite significant, totaling YEN 1.48 trillion (about US$ 15 billion) in 2003. The funding base for the system includes the fixed assets tax (the subnational property tax), the corporate share of the municipal residents tax and the landholding tax levied inside the Tokyo metropolitan region. In the metropolitan regions outside of Tokyo, these taxes are wholly allocated to cities. Tokyo prefecture gets 48% of the funds, allocated to support its provision of area-wide services such as water and sewage, fire services, and the like. The remaining 52% of the funds are allocated among the 23 ku according to need. This need is determined by calculating 14 items of the ku-level revenues and comparing the total for each ku with a calculation of standardized costs each ku incurs in delivering services. Funds are allocated to the individual ku in the event that their costs exceed their revenues. In recent years, the ku have sought to expand their scope of responsibilities and thus their share of the funds, but the metropolitan administration argues that area-wide provision of such services as sewerage and fire protection offer important economies of scale.

In short, within the Tokyo region, revenues from these select metropolitan taxes are first pooled at the metropolitan level. The funds are then used to finance the area-wide provision of such services as fire-prevention and public housing via Tokyo Metro as well as equalize the capacity of the ku (or wards) to provide services—such as garbage collection and elementary education—not left to the metro-level administration. The system is the legacy of a highly centralized fiscal and political order, both between the national government and local administrations as well as between mid-tier and local governments. Hence the system emphasizes effectiveness and efficiency in the allocation of functions, and equity in their delivery, with perhaps less thought given to securing accountability and local control. Even so, metropolitan redistribution in Tokyo assists the ku in delivering an adequate standard of municipal services, in spite of their wide diversity in economic base. This pooling of fiscal resources and redistribution helps to foster Tokyo's continuing competitiveness as a global city[10].

Most systems of metropolitan tax-sharing or fiscal equalization are not as large or complex as Tokyo's. Consolidated metropolitan government is itself not common, and particularly outside of the unitary states. There have been notable instances of annexation or consolidation to create metropolitan government, especially in the Canadian cities of Halifax, Montreal, Ottawa and Toronto. But these comprehensive strategies to gain metropolitan scale are in fact relatively uncommon (Sancton: 2003). Consolidation can promote equity since it provides a single metropolitan tax system. Regional taxation can thus even out fiscal disparities among the formerly separate municipalities of a metropolitan region. It can also promote efficiency in the delivery of services and other urban functions through expanded economies of scale and reduction in the need for cooperation and negotiation among a large number of municipalities.

But amalgamation is politically quite difficult, as the gains from consolidation are often seen as dubious whereas the costs (for example, loss of community, potential reduction in accountability) are quite salient in local residents' minds. In addition, it is often not clear that amalgamation reduces costs in a number of functions, especially when amalgamated institutions are not appropriately coordinated (McKay: 2004). As the OECD warns, not all services ought to be regionalized. Not only is it important to ensure that recipients of services pay for them (ie, the benefit principle), but sometimes too large a scale of production and distribution can exceed potential scale economies and induce inefficiencies (OECD: 2004b, 116). This caveat appears to apply in particular to fire suppression, parks and recreation, libraries, sidewalks, street lighting, road and bridges, and local land use planning (Bird: 2004, 7).

Fiscal Regionalism

An alternative to consolidation is seen in "fiscal regionalism." Fiscal regionalism is a strategy that avoids drastic revisions to the extant administrative institutions, and seeks instead to graft onto them a regional funding arrangement (Miller, 2000). There are two especially salient approaches in this area. One is the use of special dis-

10) There is as yet no comprehensive and up to date single source on fiscal equalization in Tokyo. The above information is thus gleaned from the fiscal information sections of Tokyo Metro and the Special Wards'web sites.

tricts to finance and deliver particular goods and services over part or all of a large metropolitan area. Some of these districts have specified life-times, so that they are administratively dissolved once their purpose has been served (Miller, 2000).

Indeed, governance of American metropolitan regions is notable for a profusion of regional special districts as opposed to metropolitan government per se. There is because there is "no real example of unitary, general-purpose metropolitan government in the United States" (CBASSE: 1999, 106). America's special districts largely focus on single purposes, such as providing such amenities as environmental protection, cultural facilities, transit, and so forth. Many are funded through special tax measures as well as fees and charges. A longstanding example is New York's Metropolitan Transit Authority, which manages a swathe of transit infrastructure in the metropolitan region. Another increasingly prominent and widely cited example is the Denver metropolitan area's Scientific & Cultural Facilities District (SCFD). The district comprises seven counties. Area voters approved the SCFD in 1988, granting it a 0.1% retail sales and use tax. The SCFD has since provided funding to 300 regional scientific and cultural organizations. A study of the SCFD and its effects was undertaken in 2004 by the Colorado Business Committee for the Arts. The committee worked with Deloitte Consulting, the Denver Metro Chamber of Commerce and the U. S. Bank. The study concluded that in 2003, the SCFD's regional finance of US$ 35 million greatly stimulated the region's cultural community and related business. Of US$ 1.3 billion in total economic activity, close to $500 million was deemed to derive from this funding, representing a 14:1 return on investment (CBCA: 2004).

Another example of fiscal regionalism is seen in tax-sharing arrangements that leave the structures of city government intact within the metropolitan region, but pool some of the regional revenues. Perhaps the most oft-cited case in this respect is the Minneapolis-St. Paul (Minnesota) region, which established a tax base sharing arrangement in 1971 and saw it implemented by the Minnesota state government in 1975. The scheme now includes 182 cities and townships and is governed by the Fiscal Disparities Act of 1971. Pursuant to the Act's provisions, the region's municipalities compare their current industrial and commercial property values with 1971 levels. Of the increase over the starting year, 40 percent is put into a fund and redistributed according to each jurisdiction's population and the market value of all the properties in it. The figure for market value per capita is compared to the regional average as an index of fiscal capacity. A city with a per capita value below the average receives revenues from the fund, whereas a city with an above-average per capital land value becomes a net contributor to the fund. In 2005, total revenues redistributed through the fund were US 261.4 million (DeBoer, 2005). The tax sharing system helps to apportion the benefits of development across the regions rather than to individual municipalities. This redistribution tends to reduce the incentives for jurisdictions to compete for business by offering special concessions and so forth (OECD, 2004b: 119).

Though the Minnesota model is a frequent point of reference in proposals for tax sharing, it has its limitations. Residential property is not included in the scheme and neither is fully 60 percent of commercial and industrial property values. This suggests that ample scope for tax-base competition remains. Moreover, the 1971 base year for measuring the increment of increase in property values can lock in disparities as well as impose heavier burdens on areas whose development is mostly after 1971 than before it. In addition, the tax-sharing arrangement omits the sales and income tax bases in their entirety and has no direct mechanism for assessing differences in fiscal need among the municipalities (Hinze and Baker, 2005).

Moreover, in some cases it seems neither politically feasible nor economically meaningful to move towards the metropolitan integration model or even tax-base sharing through fiscal regionalism. Some metropolitan governments have a decidedly minimalist set of tasks as well as a very low level of independent revenues. To the extent that the general fiscal structure is largely a given, and not it may be best to attempt to maximize its effectiveness. The municipalities in the metropolitan region of Mexico, for example, spend only 6.9 percent (2000) of total public sector expenditures in the metropolitan region and collect only 1.9 percent of the taxes levied in the region (OECD: 2004a, 79–84). Hence, Mexico's municipalities have such a low burden of responsibilities that the expenditure needs of wealthy versus poorer areas do not vary much. In turn, local tax rates have little potential influence on economic actors' locational decisions and municipal revenue capacity is for the most part determined by the grants received from higher levels of government. For these reasons, the OECD territorial review of Mexico City advised that reform centre on education finance. Education is critical to the entire region's growth prospects, and is one area where needs do vary significantly among municipalities. Hence, it would be advisable to adjust the distribution of education grants in recognition of the needs of the poorer municipalities (OECD: 2004a, 99).

Smart Taxation to Cope with Externalities

Another increasingly noted means of bolstering metropolitan fiscal health is via taxation aimed to alleviate negative externalities and encourage their positive counterparts. The past two decades of concern for the incentive effects of taxation have reminded analysts and policymakers of the old wisdom that one taxes what one wants less of and subsidizes what one wants more of. Smart taxes are thus aimed less at boosting revenues per se, at least directly, and more at bolstering economic competitiveness. Fiscal health is bettered by having a local economy and community less hindered by such negative externalities as pollution and traffic congestion.

One example of smart taxation is split-rate property taxation. Briefly, split-rate property taxation involves setting the rate on buildings and improvements lower than the rate on the land *per se*. Property taxes play a large role in most local government finance regimes, so there is ample scope to implement these kinds of tax measures. This approach has been used with particular success and intensity in many Pennsylvanian cities for example. It is also highly evaluated by property tax experts as a measure to encourage development in the urban core and discourage sprawl (Brunori, 2003; Jones: 2005). As noted earlier, sprawl often leads to diseconomies through exacerbated traffic congestion, more time lost in commuting, less time and fewer opportunities for interacting and exchanging ideas, and a generally less diverse and creative urban environment. The OECD territorial review of the Korean city of Busan (OECD: 2004c) argued, for example, that the "split-rate" approach affords a promising option for tax reform. This is because Busan is already geographically dispersed and would need to increase economies of scope and scale in order to achieve its objectives of becoming a research-based economy. Using tax incentives to discourage sprawl and instead encourage development in the city core could bolster agglomeration economies while reducing the diseconomies of sprawl.

Similarly, taxes can be also used to control the congestion that poses a significant problem in many, if not most metropolitan areas. The OECD territorial reports on Busan and Seoul both emphasize this point. This is because while OECD countries overall lose about 3 percent of their potential economic output through the time and resources lost on congested roadways, Korea loses about 4.4 percent (ESCAP, 2002). This level of potential output lost through congestion does not have to be accepted as a sad fact of urban life. In 2003, the city of London introduced a "congestion charge" to discourage use of the city's Inner Ring Road area's roadways (a 21 km^2 area) during peak traffic periods. Prior to the introduction of the congestion charging system, estimates indicated that fully 40% of the UK's overall traffic congestion was concentrated in Greater London and that at peak periods average vehicular speeds in central London had fallen below 16 kilometres per hour (Blow, Leicester and Smith: 2003). The congestion charging system has been widely praised, even by most of the people who pay it, because it has reduced congestion within the charging area by about 30 percent (OECDb: 2005).

Because of the visibility of London on the global stage, its charging system has attracted a great deal of international attention. But there are plenty of earlier examples. Singapore has in fact been using road pricing to control traffic since 1975, and developed the world's first electronic system in 1998. The initial system used very high fees and reduced traffic by 44 percent (Small and Gomez-Ibanez: 1998, 216–7). Another metropolitan region that is planning to introduce a congestion charge is Stockholm. At present, the city is undergoing a trial run—slated to end on July 31 2006—of a congestion-charging system, and will hold a referendum once the trial is completed. As the OECD territorial review of Stockholm observes, the city suffers greatly from congestion due to underfunding of transportation infrastructure. A congestion charge could very well help to balance the pressure for new spending with a more economically rational use of the infrastructure already in place (OECD: 2005b).

These kinds of taxes and charges are generally referred to as "smart taxes" and the urban policy that they are part of is often referred to as "smart growth." The essential point about these measures is that they are generally aimed at increasing incentives for economically productive activity and imposing disincentives for activities that impose negative externalities. These taxes and fees are not, in other words, aimed at boosting revenues. Indeed, it may be that the fiscal effect of these measures is less evident through their direct revenue stream and more diffusely the result of increased tax and other revenues overall through increased economic activity. Additional benefits might accrue from a better quality of life and the other positive externalities that arise from maintaining vital downtown areas. Smart taxation is no "magic bullet" solution to big cities' potential revenue needs, but as part of a broader and strongly incentivist approach to local tax reform, it appears well worth considering. The initial version of the Winnipeg New Deal attempted to do this, but the political environment at the provincial level was less clearly favourable to innovation. Cities clearly need to work hard in seeking cooperation from higher levels of government. One route to this end is to build a broad base of support through engaging local residents and, if possible, neighbouring governments in a dialogue about how public services might be funded in smarter ways that simultaneously build more competitive regions.

Conclusion: Towards Greater Metropolitan Fiscal Health

The boom in work on metropolitan finance and fiscal health has brought an increasingly detailed set of benchmarks into the international arena. The proliferation of research and benchmarks reflects the increasing scale of the challenges confronting urban areas. Within OECD countries, the city is most often the site where the socio-economic costs of ageing, technological change, globalization and other phenomena manifest themselves. In contrast to the broader territorial reach and thus often more abstract functions of national and mid-tier governments, urban administrations are compact in their jurisdictions and very concrete in the services they provide. These urban services have been generally taken for granted, being largely composed of "pipes, police and pavement," as former Winnipeg mayor Glen Murray described them. Yet in recent years, much more appears to be demanded of cities, and in particular the conurbations that are at the centre of the contemporary shift from industrial to knowledge-centred economies. If their finances and governance are not crafted to afford the economies and amenities that are increasingly the key to international competitiveness, then the entire country forfeits. It is thus entirely to be expected that studies of metropolitan governance and fiscal health are flourishing.

Even so, the definition of fiscal health and the prescription for how to attain it are perhaps not soon, if ever, to achieve a broad consensus among policymakers and analysts. Fiscal health is an essentially contested concept, being inherently complex and subject to value judgments on several of its critical dimensions. Yet there are some features that are constant in virtually all conceptions of fiscal health. One of these constants is the need to adhere to the benefit principle in local finance. Efforts to match fees with services have indeed become more sophisticated in recent years, with increasing attention paid to using fees as a lever in the local economy and society. This trend is evident in proposals for a tax shift among Canadian municipalities as well as the use of the congestion charge in London. The latter charge has been sufficiently successful that it has added to the momentum to introduce road charging throughout the UK[11]. The more that fees and charges are linked to promoting economic efficiency through reductions in negative externalities and waste, the more likely they will meet with popular approval as well.

A far lower degree of consensus exists in favour of tax-sharing and other forms of fiscal regionalism, to say nothing of consolidated government. There seems inevitably to be a tension between concerns to achieve region-level efficiencies and concerns that local democracy is likely to suffer from large-scale governance or even the institutions associated with revenue-sharing. Simply pointing to the potential economic benefits of metropolitan-scale governance seems inadequate. In this case, it may be useful to emphasize neighbourhood committees and other institutions that help facilitate bottom-up control over policymaking and other urban functions.

Perhaps the clearest lesson from reviewing urban fiscal health is that theoretical principles are an essential guide to assessing fiscal institutions, but also that it is important to appreciate why diversity exists in practice. Not all—and perhaps not even most—institutional diversity is the legacy of poor or skewed incentives. Much institutional diversity appears to be rooted in history, geography and sociopolitical factors. This heritage continues to shape contemporary efforts at institutional reform, and is thus a useful resource in generating different approaches to common problems. Diversity in metropolitan fiscal institutions around the OECD is a laboratory, akin to the classic American emphasis on local government as a testing ground for new ideas. In studying fiscal health, the search is ultimately for efficiency and effectiveness to help city regions cope with their specific situational imperatives as well as the broader backdrop of global challenges. There is some convergence in fiscal institutions, and the generally positive normative sense towards that convergence is implicit in benchmarking. But flexibility in adapting and innovating new institutions is also very important. After all, the aim of the enterprise is to understand and promote metropolitan fiscal health, not homogeneity.

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11) The UK Department of Transport's July 20, 2004 White Paper "The Future of Transport" lauds London's congestion charge as a "world leading" scheme. Also, in an official reponse of July 20, 2005 the same department responded to its own Select Committee's (an advisory body) call for nationwide road pricing and indicated that it would encourage local governments to set up road pricing schemes that could later become the elements of a national network.

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