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Citistates and the State of Cities: Political-Economy and Fiscal-Federalism Dimensions

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Les villes, plus particulièrement les villes-régions internationales, sont devenues les plaques tournantes de l'ère de l'information. Bien que ces villes-régions aient actuellement une fiscalité fragile et n'aient pas de référence constitutionnelle en matière juridique, leur ascension est telle qu'elles deviendront entièrement et formellement intégrées au sein de la structure et du processus fédéral politique et institutionnel. Par conséquent, les objectifs de ce chapitre sont, en premier lieu, d'expliquer l'ascendance des villes dans ce nouvel ordre global, et en deuxième lieu, de se concentrer sur différentes solutions qui permettront aux villes de développer leurs compétences, leur autonomie fiscale et l'élargissement et l'intensification de leurs rapports avec les autres paliers de gouvernement. En développant ces thèmes, ce chapitre s'inspire de l'expérience internationale similaire qui se rapporte aux états tant fédérés qu'unitaires, en se donnant la possibilité d'imiter le système allemand où certains länder sont des villes-états (Berlin, Brême et Hambourg), comme le titre « villes-états » de ce document le sous-entend.

The world, economically and in management terms, has become a network of prosperous regions, prosperous city-regions.

Kenichi Ohmae, 2000

It is certain that the future of democracy as the capacity of people to act on their own future, at the juncture of social identities and personal subjectivities, will be at the local level.

Michel Autès, 1997, citing A. Touraine, 1994

INTRODUCTION

These quotations speak directly and dramatically to the economic, political and democratic ascendancy of cities in the knowledge-based economy (KBE), and especially to the ascendancy of what have come to be referred to as citistates or global city-regions (GCRs). In line with this vision, the role of the ensuing analysis is essentially twofold. The first is to elaborate on why and how GCRs have become the new and dynamic motors of the information era. This is a global development, not unique to Canada. The second role of the paper is, however, quintessentially Canadian: Given that our GCRs are fiscally weak in a comparative context and jurisdictionally constitutionless in the Canadian context, how might they evolve so that they can indeed fulfill their promise as the empowering engines of our local, national, and global economies?

Toward these ends, the analysis begins with "Global City-Regions in Ascendancy," which focuses on a range of new roles and rationales that are catapulting cities onto the policy and jurisdictional centre-stage. Included under this rubric will be brief discussions of why cities are now the key players in both the old geography (the space of places) and the new (the space of flows). This will be followed by a discussion of GCRs as magnets for attracting what Richard Florida calls the "creative class," together with an assessment of how Canadian GCRs are doing in this regard. Rounding out this discussion is a focus on the differing needs of all cities, on the one hand, and those of the GCRs, on the other.

Under the heading "The Fiscal and Jurisdictional Challenges Facing Canada's GCRs," the analysis then addresses the revenue and expenditure patterns of Canadian cities in comparative domestic and international contexts. This is followed by a review of the recent evolution of federal-provincial political and fiscal relations and the manner in which this is impinging on the prospects for Canada's GCRs. The section concludes with a brief note on the relationship between fiscal autonomy and democracy/accountability.

The final substantive section, "Alternative Policy Futures for the GCRs," addresses the various avenues by which Canada and Canadians might capitalize on the KBE potential of our global city-regions. This begins by focusing on the variety of possibilities for enhancing the revenue autonomy of cities, both by increasing reliance on the full range of existing (but often unused) revenue sources and by tapping new sources, including tax-sharing options from senior government levels. Next, attention is directed to the ways in which the federal-GCR interface is already evolving, with a discussion of the prospects for further creative evolution. This is followed by a similar assessment of the likely evolution of the provincial-GCR interface. The analysis ends by redirecting attention back to the GCRs themselves, including some speculation relating to the option of their achieving citistate or city-province status along the lines of the German city-Länder of Berlin, Bremen, and Hamburg.

The paper ends with a brief conclusion that highlights the prospects for Canada's GCRs to achieve the lofty societal heights articulated in the opening quotations.

While this paper is intended, in principle, to have general application across Canada and across all GCRs, most examples will be drawn from Ontario. Readers will have to judge for themselves how much this impinges on its intended generality.

GLOBAL CITY-REGIONS IN ASCENDANCY

GCRs AS THE DOMINANT EXPORT PLATFORMS IN THE SPACE OF PLACES

Were one to parse the new societal order into its globalization component and its KBE component, in terms of the former the most straightforward rationale for the enhanced role of GCRs is that they are in the forefront of regional and global economic integration. All Canadian regions (and at last count, all but one of Canada's provinces) are more integrated with the United States in terms of aggregate trade flows than they are with the rest of Canada. This led Colin Telmer and me to proclaim that Ontario (and perhaps by now several other provinces as well) had donned the mantle of what we labelled a North American economic region-state (Courchene and Telmer 1998). Yet it is patently evident that the evolution of Ontario's region-state status is, for all intents and purposes, about the evolution of Toronto and the Greater Toronto Area (GTA) in the direction of becoming a global city-region (Courchene 2000). More generally, Vancouver, Edmonton/Calgary, Winnipeg, Toronto, Montreal, and Halifax, among others, are the driving force behind their respective regions' and provinces' integration in NAFTA economic space. Hence, cities and, in particular, global city-regions have achieved pride of place in conventional economic geography – or what Manuel Castells (2001) refers to as the "space of places."

GCRs AS NATIONAL NODES IN THE GLOBAL SPACE OF FLOWS

More recently, however, cities have also come to be viewed as the paramount jurisdictional players in terms of the KBE component of the new societal order – or what Castells calls "the space of flows." One facet of this is that in the KBE, knowledge and human capital are progressively at the cutting edge of competitiveness. Another facet is that the network, powered by the Internet, has become the dominant space-of-flows organizational form (Castells 2001, 1). In tandem, these hallmarks of the information era come to the fore in global cities, since it is in these cities that one finds the requisite dense concentrations of human capital, research and development, high-value-added services, et cetera, that allow GCRs to become the key coordinating and integrating networks in their regional economies while also performing as dynamic national nodes in the international networks that drive growth, trade, and innovation in the global economy. While this resulting space-of-flows or networked geography is a new form of space, it is not placeless. Indeed, as Lever (1997, 44) notes, underpinning the importance of these global cities is that they assume the (network) role of a command, control, and management centre for their domestic and international economies. Phrased somewhat differently, the GCRs breathe life into the emerging regional-international interface that is replacing the traditional nation-nation interface as the dominant integration linkage. Perhaps the role of GCRs – embracing as it does both the space of places and the space of flows – is best described as the "space of networked places" (Castells 2001, 235).

Thus, in this framework, GCRs assume two economic roles – as dynamic export platforms and as learning and innovation platforms – which in tandem attract industry clusters, which in turn attract talent (human capital) in search of rewarding and remunerative work. Yet this people-to-jobs or people-to-industry causation is now being complemented – and in some ways even supplanted – by the opposite industry-to-people causation, arising from the human-capital and quality-of-life aspects of city competitiveness, to which this analysis now turns.

THE "CREATIVE CLASS," COMPETITIVE ADVANTAGE, AND GCRs

Appropriately, the third perspective by which to envision the rise of GCRs puts the focus on the GCRs themselves. In his international bestseller *The Rise of the Creative Class* (2002; 2004), Richard Florida builds on the human-capital/knowledge paradigm by introducing human creativity, or the "creative class," as a GCR's ultimate economic resource (Florida 2004, xiii). Specifically, Florida views these GCRs as the key economic and social organizing units of our era, and he believes that the cities that come out on top will be those that fare best in terms of his "3 Ts": technology (as measured by innovation and high-tech industry concentration), talent (as measured by the number of people in creative occupations), and tolerance (as measured by the amenities and opportunities available for every possible lifestyle). Cities that score well, especially with respect to the tolerance component, will become places where the creative class will cluster. For their part, companies will then cluster in those same places to draw upon the concentrations of the various creative classes and their ability to power innovation and economic growth. Florida labels this the "creative capital theory" of regional economic growth and development.

Even though creative capital theory is likely to be oversold initially, as is the case with many new ideas, it is nonetheless a most welcome addition to the literature on the competitiveness of cities because, as noted, it is centred on the management and organizational attributes of cities. While it will still be an advantage to have a world-class university in your midst, or to be sitting on a major resource deposit, or to have access to the full range of high-value-added business services, the new reality is that initial endowments are no longer as determining, let alone as predetermining, and that by positioning themselves high in the quality-of-life features GCRs can come out on top in the competitiveness sweepstakes. In Florida's words:

> It's often been said that in this age of high technology, "geography is dead" and place doesn't matter any more. Nothing could be further from the truth: Witness how high-tech firms themselves concentrate in specific places like the San Francisco Bay Area or Austin or Seattle. Place has become the central organizing unit of our time, taking on many of the functions that used to be played by firms and other organizations. Corporations have historically played a key economic role in matching people to jobs, particularly given the long-term employment system of the post World War II era. But corporations today are far less committed to their employees and people change jobs frequently, making the employment contract more contingent. In this environment, it is geographic place rather than the corporation that provides the organizational matrix for matching people and jobs. Access to talented and creative people is to modern business what access to coal and iron ore was to steelmaking. It determines where companies will choose to locate and grow, and this in turn changes the ways cities must compete. As [former] Hewlett Packard CEO Carly Fiorina once told this nation's governors: "Keep your tax incentives and highway interchanges; *we will go where the highly skilled people are*." (Florida 2004, 6, emphasis added)

In *A State of Minds: Toward a Human Capital Future for Canadians* (2001), I asserted that the knowledge/information revolution would do for human capital what the Industrial Revolution did for physical and financial capital. Florida expands this analogy to go beyond human capital to embrace "human creativity." His core message is that "human creativity is the ultimate source of economic growth. Every single person is creative in some way. And to fully tap and harness that creativity we must be tolerant, diverse, and inclusive" (2004, vi). This is part and parcel of the emerging reality that citizens, individually and collectively, are not only the principal beneficiaries of the KBE but are also the driving force underpinning the burgeoning of the KBE itself. Florida's insight is that successful GCRs, as well as providing an inviting environment where the creative class can cluster, will also supply an organizational spatial and network matrix for matching talent and jobs.

CANADA'S GCRs AND FLORIDA'S "3 Ts"

Given the multicultural nature of Canadian society, it should come as no surprise that Canadian GCRs, especially major immigration-receiving cities such as Toronto, Vancouver, and Montreal, rank very high in terms of Florida's tolerance index. This is because the index is a combined measure of the high-profile gay index, the bohemian index (the percentage of artistically creative citizens), the melting pot or mosaic index (the percentage of foreign-born population), and the racial integration index (a measure of the geographical diversity of racial groups).

Table 1, based on data from Gertler et al. (2002), shows how Canada's largest cities rank on selected elements of Florida's index, where the comparison is among the forty-three North American city-regions with a population in excess of one million. Toronto ranks fourth in terms of the bohemian index and first in terms of the mosaic index, thanks in part to its large immigrant population. Where Toronto does not perform all that well is in terms of Florida's other two Ts – the talent index (percentage of population with a university degree) and the technology index (high-tech concentration). As Gertler et al. (2002) note (again among forty-three North American city-regions), Toronto ranks twenty-fourth and fifteenth for talent and technology, respectively. Rankings for other Canadian GCRs with populations over one million are qualitatively similar, although Ottawa receives particularly high marks for talent.

Table 1: Rank of Canadian Cities for Various Elements of the "3 T index" among 43 North American Cities

	Talent	*Mosaic*	*Bohemian*	*Technology*
Toronto	24	1	4	15
Montreal	43	7	10	13
Vancouver	31	2	3	29
Ottawa	10	9	14	23

Source: adapted from Gertler et al. (2002)

Confirmation that Canada's cities should be the focus of policies to address lagging prosperity – and that our cities need in particular to improve their position in terms of the indexes for talent and technology – comes from related research that Roger Martin and James Milway (2003) carried out for the Institute for Competitiveness and Innovation and summarized in the *National Post*. Martin and Milray note that the entire gap between per capita GDP in Ontario and that of the average U.S. state is an *urban gap*. Rural Ontario more than holds its own with the rural United States, but this is not the case for Canadian cities versus U.S. cities. Closing this gap, according to Martin and Milway, requires redressing four factors: attitudes (for example, lower university enrolment in Ontario); investments (private investment to enhance productivity and public investment in education and human capital); incentives/motivation (higher tax rates in Canada); and fiscal and governance structures.

While GCRs can and must play key roles in creating a learning and innovative environment, addressing the talent and technology shortfall, whether defined by Gertler et al. or by Martin and Milway, requires a societal commitment to what might be termed "policy infrastructure," and this clearly transcends the boundaries and powers of the GCRs. Arguably, the most important component of this policy infrastructure relates to the creation of human capital. In *A State of Minds*, I went as far as to propose a formal "human capital mission statement" for Canada and Canadians as the cornerstone of twenty first-century public policy (Courchene 2001, 154): "Design a sustainable, socially inclusive and internationally competitive infrastructure that ensures equal opportunity for all Canadians to develop, to enhance and to employ in Canada their skills and human capital, thereby enabling them to become full citizens in the information-era Canadian and global societies." Were Canada to embrace such a mission statement, our GCRs and Canadian society generally would clearly climb in the rankings of Florida's talent and technology indexes. In any event, the message here is that the jurisdictional responsibility for undertaking societal policies of this type – increasing the human capital of all Canadians – must reside well beyond the city level, even if cities end up as the jurisdiction that most benefits from such a policy. In this regard, we should all welcome Ottawa's recognition in the 2004 federal budget that we trail the Americans in terms of the percentage of university graduates, and we should also welcome the creative policies the budget adopted to close this gap.

Along similar lines, the "employ in Canada" component of the above mission statement is related to another policy requisite for cities' success, namely that Canada must ensure that our tax rates on mobile factors – physical, financial, and human capital – are competitive with rates existing internationally, and particularly with those prevailing in the United States. If ensuring that these tax rates are competitive leaves the federal or provincial governments with a revenue shortfall, the way to restore any such shortfall is via an export/import neutral consumption tax, for example, the GST. Canadian GCRs will not achieve their potential if, because of unlevel playing fields on the tax front, they become only temporary stopping points for our talent and human capital en route to sunnier economic climes elsewhere.

GCRs VERSUS OTHER URBAN CENTRES

Obviously, many of the forces privileging GCRs are also privileging other cities. For example, the falling cost of information allows for the delivery of more services to be assigned, in accordance with the principle of subsidiarity, to the jurisdiction that is "closer to the people," as it were. Whereas the term "decentralization" in the Canadian federation has typically meant passing powers from Ottawa to the provinces, the implications of the subsidiarity principle in the KBE would suggest that selected powers can and should be devolved from both Ottawa and the provinces to GCRs and, for many services, to cities generally. Likewise, the need to increase the fiscal autonomy of GCRs in order to improve efficiency, accountability, and citizen participation would also apply to the entire municipal sector.

However, as already noted, the raison d'être of this paper is that the GCRs are different, not only because of their size per se but because of the critical roles they play in the KBE. Some of these roles have already been outlined – export platforms, dense nodes of human capital, and centres of concentration for business services, research and development, and information technology – all of which combine to drive KBE innovation and competitiveness. Moreover, GCRs typically have infrastructure, transit, and logistics challenges of a magnitude not shared by smaller urban areas. And as the principal immigrant and refugee receiving areas, GCRs are saddled with very substantial settlement costs (language and skills training, income support, housing, etc.). Finally, but hardly exhaustively, GCRs are large enough to employ a critical mass of civil servants so that for many of the functions they have the analysis and design capacity to compete in terms of policy formation with federal and provincial bureaucrats.

Simon Fraser's Richard Harris has aptly captured the essence of all of this when he asserts (2003, 50) that the collective future of Canadians depends on how our global cities will perform relative to U.S. global cities. Indeed, over the last decade Canada's six biggest urban areas have enjoyed a 30 percent increase in total employment, double the percentage advances for smaller metropolitan areas and for Canada's towns and rural areas (Little 2004). Moreover, international research shows that a doubling of city population leads to a 4–5 percent increase in productivity as measured by output per capita (Strange 2003).

Having thus made the case for special treatment for Canada's GCRs in order that they may achieve their information-era potential, the remainder of this analysis identifies the two Achilles' heels of Canada's GCRs. The first is their lack of fiscal autonomy and the associated view that they are ideal places from which to redistribute revenue, whereas the emerging KBE reality is that GCRs ought to be able to retain a much larger share of the revenue generated from within their boundaries. The second, and related, challenge facing GCRs is that they are constitutionless – they are creatures of their respective provinces. The next section will identify and document, often in comparative context, these fiscal and federal challenges. The section following that will address the range of alternative policies, instruments, and processes that would allow the GCRs to become more fiscally and federally integrated into our KBE future.

THE FISCAL AND FEDERAL CHALLENGES FACING CANADA'S GCRs

THE FISCAL CHALLENGE

The fiscal reality facing the GCRs is that they rely almost exclusively on property taxation and provincial transfers for their revenues, which means that they typically do not have access to a tax base that automatically grows apace with incomes and population (such as a share of income taxes, of general sales taxation, or even of specific excises such as gasoline taxes). In turn, and almost by definition, this lack of revenue-raising capacity serves to constrain the GCRs' expenditure autonomy. As the TD Bank (2002a, press release) noted, "Canada's cities have much to offer including a highly diverse workforce, geographical proximity to the large US market and a competitive cost base. Yet ... in many cities infrastructure is deteriorating rapidly. Social housing, water systems, sewers, roads and public transit systems all require massive re-investment, but cash-strapped cities are in no position to deliver." What follows is a brief review of the fiscal position of Canadian cities in a domestic and an international context, beginning with expenditures.

Expenditures

Table 1 of Melville McMillan's paper (this volume) reveals that for the calendar year 2001 there were very substantial variations in per capita municipal expenditures across provinces – from a low of $378 for Prince Edward Island's municipalities to nearly $2,000 for those in Ontario, for an all-Canada average of $1,545. The principal reason for these wide disparities is that cities shoulder different responsibilities across provinces. For example, as McMillan's table 1 indicates, Ontario cities spend 25 percent of their budgets on social services – a proportion that is over five times more than second-place Nova Scotia (and more than ten times more in terms of per capita spending). On the other hand, Nova Scotia municipalities spend nearly 15 percent of their budgets on education, whereas in all other provinces the municipalities spend negligible amounts, since responsibility for education has been taken over by the provinces.

While it is likely the case that cross-province differences in municipal spending are as large as cross-country differences, some international comparisons are nonetheless in order. In an earlier paper, McMillan (1997) compares data for selected cities in the mid-1990s. He notes that Melbourne spends only US$723 per capita (in large measure because police and schooling are the responsibility of the Australian states), whereas Pittsburgh (which shoulders much of education spending) spends US$2,894, and Toronto spends US$1,839. In terms of cities in federal systems, Frankfurt tops McMillan's list at US$4,979. The German federation may be rather unusual among developed federations because the Basic Law (the German constitution) states that communities must be guaranteed the right to regulate all the affairs of the local community within the limits set by law; and to accommodate this on the revenue side, in addition to receiving revenues from real estate and business taxation, the Basic Law provides for the communes to receive a share of personal income tax and corporation tax (articles 106(6) and 107(1), respectively). For example, personal income taxes are shared equally between the federal government and the Länder governments, with each government level then transferring 7.5 percentage points of the personal income tax to the communes or municipalities. This type of constitutionally mandated tax sharing and regulatory responsibility for municipalities also exists in other federations – in Mexico, for example. However, it is in stark contrast to the Canadian reality where, as already noted, Canadian cities are not mentioned in the *Constitution Act, 1867* (except of course to place "Municipal Institutions in the Province" under the exclusive jurisdiction of the provinces (section 92(8)).

Intriguingly, cities in unitary states frequently tend to have *greater* expenditure and revenue-raising autonomy than Canadian cities do. This is less puzzling than it might at first appear, because any commitment to the principle of subsidiarity in unitary states necessarily means greater powers for cities, since this is the only subnational government level in unitary states. In the Canadian context, the frequent calls for more decentralization nearly always mean transferring powers from Ottawa to the provinces. However, as noted earlier, for many policy areas decentralization to the city/municipal level is, thanks to the information revolution, increasingly possible as well as being consistent with the subsidiarity principle. Partial evidence in the direction of confirming the proposition that unitary states pass more authority down to cities is that Stockholm's per capita spending is US$10,644 (McMillan 1997), more than double Frankfurt's and close to six times Toronto's per capita spending.

Revenues

Mcmillan's table 2 (this volume) reveals that property taxes account for between 48.3 percent (Ontario) and 73.1 percent (Nova Scotia) of overall municipal funding, with an all-Canada average of 52.2 percent of overall revenues (and 63 percent of own-source revenues). Note that since Ontario's cities are the highest per capita spenders, this should imply (all other things being equal) that property taxes account for a smaller proportion of revenues for Ontario cities. Sales of goods and services (including fees and charges) are the other major component of own-source revenues, averaging 28 percent (and 23 percent of overall revenues). Transfers from other levels of government account for 17 percent of overall revenues. For the most part, these are in the form of conditional transfers (14.6 percentage points of the 17), which may not relate to the internal priorities of cities. The remaining 2.4 percentage points take the form of unconditional grants. Note that the overwhelming proportion of these transfers are provincial-municipal transfers; direct federal-municipal transfers in 2001 were less than 3 percent of total transfers and only 0.4 percent of overall municipal revenues.

By way of international comparisons, Frankfurt obtains much of its revenue from a 15 percent share of federal and Länder income taxes, whereas 35 percent of Stockholm's significant revenues come from a sharing of Sweden's personal income tax (McMillan 1997). It is true that cities in some provinces also have access to shared taxes. For instance, Manitoba municipalities receive a share of provincial personal and corporate income taxes; Alberta cities receive a capital grant for roads and transit based on fuel consumption in each city; and Vancouver, Victoria, and Montreal have access to a share of gasoline taxes). Nonetheless, the resulting tax sharing does not loom large in terms of the overall fiscal needs of cities. However, these examples are important in that they provide excellent models of appropriate tax sharing, which needs to be broadened, enriched, and, of course, replicated elsewhere.

As a bridge between this section on the fiscal gap and the following one on the jurisdictional gap, it is appropriate to note that Canada's cities frequently suffer from "unfunded mandates," or fiscal downloading from both levels of government. For example, Ottawa's decisions with respect to immigrants and refugees will duly commit Toronto to a range of settlement services, which Ottawa only partially funds (especially in light of what Ottawa transfers to Quebec for such services). Likewise, Queen's Park has devolved responsibility for social housing onto Ontario's cities, but not with sufficient funding, at least from Toronto's perspective. In the years immediately following the huge cuts in the Canada Health and Social Transfer (CHST) in the 1995 federal budget, the provinces could legitimately make the case that they were merely transferring to the cities part of what Ottawa had downloaded onto them. While this is small comfort to the cities, their current situation is even less encouraging, because the provinces have become trapped in what I have elsewhere referred to as "hourglass federalism" (Courchene 2004). This will be part and parcel of the following discussion of the GCRs' fiscal and political role in the federation.

THE JURISDICTIONAL CHALLENGE

Ottawa, Nation Building, and Cities

In the prime of the resource-based economy and paradigm, much of nation building tended to be bound up with resources and megaprojects – oil, hydro, pipelines, railways, mining, potash, the Seaway, and the like. In the KBE, nation building has much more to do with human capital and therefore with citizens. Moreover, what now sells electorally are such issues as health, quality of life, democratic participation, and, of course, developing skills and human capital to be successful in the KBE. Whereas megaprojects were likely to be resource-based and rural, nation building in the KBE is predominantly citizen-based and, perforce, largely urban.

As already highlighted, knowledge and human capital are at the cutting edge of competitiveness in the information era. And where competitiveness is at stake, Ottawa *will* become involved, regardless of what the written constitutional word may say. For present purposes, it is sufficient to note that cities and especially the GCRs are the principal repositories of human capital and therefore of KBE competitiveness, which in turn implies that Ottawa will necessarily become strategically as well as politically involved in city matters.

Hourglass Federalism

Ottawa has, of course, grasped the enormous significance of this marked shift in the determinants of nation building, competitiveness, and political salability. However, cities fall under provincial jurisdiction, as do many of the policies relating to citizens and to competitiveness in the KBE. Not surprisingly, the result has been and will continue to be a jurisdictional tug-of-war between Ottawa and the provinces in terms of addressing KBE-related city issues. For the federal government, the challenge is how to make inroads into these areas of provincial jurisdiction. “Hourglass federalism” is the label that in my view rather aptly describes the way in which Ottawa has unwittingly gone about doing this.

As part of the adjustment to the dictates of the KBE, Ottawa transferred aspects of old-paradigm nation building (forestry, mining, energy, etc.) to the provinces, presumably in part to make room on the federal policy plate for new-paradigm policies and programs. The key initiative, however, was the set of deep cuts in the CHST transfers to the provinces contained in Paul Martin’s 1995 federal budget as part of a series of measures to eliminate the deficit. To be sure, these cuts were part of Canada’s remarkable fiscal turnaround and its emergence, in the words of the *Economist*, as the “fiscal virtuoso” of the G7. However, there were some rather dire consequences for the provinces associated with these CHST cuts. Specifically, as Ottawa shifted away from direct transfers to the provinces (by abolishing the Canada Assistance Plan and reducing the CHST), it began to replace them with direct transfers to citizens (such as millennium scholarships, Canada Research Chairs, and the Canada Child Tax Benefit) and with direct transfers to cities (such as homelessness grants, the GST exemption, and the proposed federal gas tax sharing).

As the federal deficit downloading to the provinces began increasingly to constrain the provinces' fiscal position, an even more problematic fiscal dynamic came into play. Because of the electoral salience of medicare, the provinces have been unable to reduce expenditures on health care. Indeed, all provinces have increased health-care expenditures. But this meant that they were forced to starve virtually every other provincial policy area in order to feed medicare's voracious appetite. Not surprisingly, Canadians and cities alike began to be very receptive to new federal initiatives in these policy-starved areas.[1]

Thus, as Ottawa bypasses the provinces to deal directly with Canadians and with cities in areas typically viewed as falling under provincial jurisdiction, the provinces find themselves as the squeezed middle of the division-of-powers hourglass – hence, hourglass federalism. Intriguingly, with health-care spending heading towards 50 percent of program spending, the provinces will continue to find themselves trapped in this squeezed middle unless they can either download aspects of medicare to citizens or upload aspects to Ottawa. The Ontario Liberal government did the former when it delisted several previously insured items (eye examinations, physiotherapy, and chiropractic services) and introduced a dedicated and income-tested health-care levy. At the July 2004 meeting of the Council of the Federation at Niagara-on-the Lake, the premiers proposed a two-tiered strategy to combat the challenges posed by hourglass federalism: (1) upload pharmacare to Ottawa, and (2) request dramatic increases in health and equalization funding. At the fall 2004 first ministers' meetings, Ottawa took a pass on the first option but agreed to provide nearly $75 billion new transfer money to the amounts already committed over the next ten years. While this may go a long way to alleviate much of the medicare cost overhang, it is not clear that it will be enough for the provinces to redress their spending deficits elsewhere in their budgets, including municipal funding. In any event, the message here is that the politics and economics of hourglass federalism have served to worsen the fiscal position of Canada's cities and to pave the way for the federal government to embark on a series of initiatives designed to foster a closer relationship with the cities.

For their part, the cities have obviously welcomed the federal initiatives and overtures. Indeed, via the Federation of Canadian Municipalities and other associations such as the C5 (Toronto, Montreal, Vancouver, Winnipeg, and Calgary), cities have actively lobbied for these federal initiatives. Fundamentally, it is arguably preferable from the cities' point of view to have two patrons rather than just one. And on the more substantive side, Canada's GCRs look with a combination of competitive concern and envy at their sister GCRs in the United States which have direct access to Washington for infrastructure funding. This is a levelling-the-playing-field argument, important in its own right, but it takes on added importance in the current context where the provinces are squeezed by hourglass federalism. As we shall see below, Ottawa has clearly heard and heeded the cities' call.

By way of a final challenge facing Canada's cities, attention is now directed briefly to issues relating to democracy and accountability.

DEMOCRACY AND ACCOUNTABILITY

The growing influence of the GCRs has generated an increasing interest in big city politics, as evidenced by the star status of former Winnipeg mayor Glen Murray, Vancouver's Larry Campbell, and the excitement associated with the election of Toronto mayor David Miller. Indeed, Canada's GCR mayors will in all likelihood become better known internationally than their respective provincial premiers. Certainly, the mayors of New York City and Chicago have typically been better known than the governors of New York and Illinois. (Admittedly, the governor of California is a notable exception!)

Nevertheless, while cities may in theory be ideal places for democracy and accountability to flourish, the Canadian reality is, with some notable exceptions, very different. Understandably, citizens will not become too excited about democracy and accountability at the city level as long as cities are largely administrative units. Indeed, as long as cities are kept under a tight fiscal leash by their respective provinces, the collective citizen mind-set will tilt towards the administrative/rent-seeking mode rather than the policy-intensive and, therefore, participation/accountability-enhancing mode.

ALTERNATIVE POLICY FUTURES FOR THE GCRs

The first substantive section of this paper focused on the variety of ways in which globalization and the knowledge/information era have been privileging cities, especially GCRs. It may well be that the assertion that "this is the century of the city state" (Gillmor 2004, 42) is going a bit far, but it nonetheless captures the spirit of recent thinking both here and abroad. The next section of this paper was a reality check of sorts, highlighting some of the fiscal and federal roadblocks that stand in the path of cities trying to reach this potential. It follows, therefore, that much of the task in the remainder of this paper involves articulating a series of proposals and recommendations that will overcome or otherwise circumvent these roadblocks in order to enable our cities to prosper. These proposals include rethinking and reworking both the provincial-GCR interface and the federal-GCR interface, as well as considering a range of creative, albeit sometimes controversial, options that may be open to GCRs if other avenues remain blocked. This analysis begins with the revenue challenge facing municipalities generally.

DIVERSIFYING REVENUE SOURCES

Increasing Reliance on Existing Sources

While addressing options for providing cities with new revenue sources remains uppermost in policy circles as well as in the media, attention needs to be focused initially on cities' existing but frequently unused or overlooked revenue sources. Canadian cities would do well to cast their eyes internationally to recognize their untapped revenue opportunities. Thankfully, Winnipeg and its former mayor Glen Murray have been leading the way in recognizing them. A recent *Saturday Night* feature entitled "The City Statesman" elaborates as follows on Murray's views and proposals:

> Under the Canadian Constitution, cities aren't designated as a separate order of government; they operate under provincial jurisdiction. In effect, they are glorified utilities. Their means of raising revenue are limited, with property taxes being the main source. Winnipeg relies on property taxes for over 50 per cent of its revenue. But property taxes in Winnipeg are already high, and they are a flat tax: they don't rise as economic activity increases. For cities to prosper, Murray argues, they need a piece of the growth revenues, including sales tax, GST, income tax and corporate tax.
>
> He [Murray] proposes a complete overhaul of an antiquated tax system, which would reflect a closer relationship between taxation and behaviour. Thus, a fuel tax would punish SUVs and trucks and have a marginal effect on fuel-efficient vehicles. According to Murray, 80 per cent of police calls are alcohol-related, and so a liquor tax would go toward the police budget. A fee for garbage pickup would have the greatest impact on those who fail to recycle. (Gillmor 2004, 40)

Leaving the sharing of sales and income taxes to the following section, it can be seen that each of Murray's specific tax or user-fee proposals would (as well as raising revenue) fall into one or more of the following categories: accountable, pro-environment, transparent, efficient. Thus, it is surprising that Canadian cities have not followed their sister cities internationally in being more actively engaged in these user-fee and optimal-pricing approaches. Part of the problem here may be that Canada does not have a tradition of "pricing" the outputs of the public sector generally – for example, the lack of peak-load pricing for electricity and lack of incentive pricing for conserving water. (Perhaps the real, but unstated, fear here is that the imposition of user fees in these municipal service areas would open the door to thinking about applying them elsewhere in the provincial domain, in particular in the health-care area.)

Well before Glen Murray aired his proposals, Berridge (1999) provided a framework capable of incorporating and even expanding on these Winnipeg proposals:

> [Toronto and the GTA] have to decide what activities the city-region should not finance off the tax base, scrutinizing all the operating municipal services businesses – electricity, water and waste water, garbage, transit – and creating new organizations largely able to meet their own needs. Toronto is one of the few world cities that still operates these services as mainline businesses. The ability to use the very substantial asset values and cash flows of these municipal businesses is perhaps the only financial option to provide the city-region with what is unlikely to be obtainable from other sources: its own pool of re-investment capital. Such an urban infrastructure fund would have remarkable leverage potential, both from public-sector pension funds and from other private-sector institutions.

Hence, it is important to underscore the fact that there is much that cities can do to increase their revenue (and, by extension, their expenditure) autonomy by drawing on the revenue opportunities within their own jurisdiction. Creative experimentation along the lines of the Winnipeg mayor's proposals would be most welcome.

Despite the potential for raising revenue within current jurisdictional constraints, this avenue will fall short of meeting cities' expenditure requirements. As a result, current attention is focused primarily on ways in which the senior levels of government can share their revenues with, or devolve new revenue bases to, the cities.

Finding New Revenue Sources

The increasing awareness of the strategic economic importance of GCRs and the serious challenges they face is exemplified by three (thus far) ambitious policy reports on the future of Canada's cities published by the TD Bank. The titles of these reports are of interest in their own right: *A Choice Between Investing in Canada's Cities or Disinvesting in Canada's Future* (22 April 2002); *The Greater Toronto Area (GTA): Canada's Primary Economic Locomotive in Need of Repairs* (22 May 2002); and *The Calgary-Edmonton Corridor: Take Action Now to Ensure Tiger's Roar Doesn't Fade* (22 April 2003). This series is a clarion call for a new way of thinking about Canadian cities so that they will become more robust and vibrant and will also become an integral part of the TD Bank's overarching vision for Canada, namely that Canada surpass the United States' standard of living within fifteen years.

As part of this new way of thinking about Canadian cities, the TD Bank argues for a national approach to this challenge, one that provides cities with the administrative and financial power to move forward without increasing the overall regulatory or tax burden for Canadians. Toward this end, the TD report's recommendations stress that "Canadian municipalities should be granted additional taxation powers to ensure that they have access to independent sources of revenues – sources that enhance accountability, transparency, efficiency and equity. The best option is a new excise or sales tax collected on behalf of cities by the provincial or federal governments. Provinces should also allow municipalities the flexibility to levy property taxes, user fees and development charges" (2002a).

While Frankfurt and Stockholm have, as noted earlier, access to a significant share of their countries' income taxes, most of the attention in Canada has focused on cities gaining a share of sales or excise taxes – the federal GST, provincial and/or federal excises on gasoline, and provincial sales taxes (PSTs). But given that both the provinces and Ottawa now have access to the personal income tax (PIT) base, sharing the PIT should also be included in the set of choices. This option is especially relevant if the aim is to privilege the GCRs, because sharing the PIT on a derivation basis will provide the GCRs with a larger per capita value than typically would be the case for smaller cities.

The TD report went on to note that while federal and provincial grants can be used to address cities' accumulated funding shortfalls, such grants are the wrong vehicles for financing cities' ongoing financial needs; the preferable way to finance ongoing needs is by sharing the revenues of a growing tax base. A discussion of the pros and cons of tax sharing versus intergovernmental grants, as well as the variety of ways that tax bases can be shared, can be found in the appendix to this paper.

Summary

The core message here is that Canada's cities need enhanced fiscal autonomy. While much of the ongoing public debate has focused on cities gaining access to new revenue sources via tax sharing, it is important to reiterate that there also exist significant but unutilized revenue opportunities that are fully within the cities' own jurisdiction. In any event, the underlying rationale for enhanced revenue autonomy is to allow cities greater expenditure autonomy. At one level, this will serve to activate the principle of subsidiarity at the city level. At another, the traditional emphasis on competitive federalism and the importance of provincial experimentation in terms of the financing, design, and delivery of public goods and services will in effect be "decentralized" to cities. In this regard, it is instructive to recall that the seminal "Tiebout model" of competitive federalism was in effect a "competing-local-governments" model.

Moreover, enhancing the link between revenues and expenditures is a way to improve accountability, as well as allowing cities more flexibility in responding to their citizens' policy wishes. This has the potential not only for increasing the static and dynamic efficiency of Canada's cities but, also for drawing citizens into greater civic involvement, since much more will now be at stake in city governance.

These dynamic efficiencies arising from enhanced fiscal autonomy and competition among cities are appropriate for all cities, small and large. However, since Canada's employment growth, competitiveness, and living standards depend on how our GCRs fare in relation to their international counterparts, privileging the GCRs in terms of enhanced fiscal powers as well as more formal integration into the operations of Canadian federalism must rank high on the policy agenda at both the federal and the provincial level. For example, while Canada has traditionally viewed the GCRs as appropriate places to redistribute from, it is critical for the success of Canadian GCRs in a NAFTA environment that they be able to retain a larger share of the revenues generated within their boundaries. This may be a tough sell politically, though one of the noteworthy features of the 2004 federal election was that it brought cities and city issues (along with medicare, of course) to the policy centrestage.

In addition to this political economy challenge, the institutional and jurisdictional hurdle is likely to be every bit as daunting – namely, how to integrate Canada's GCRs more fully and more formally into the operations of Canadian federalism. We begin the assessment of the prospects for creative approaches to Canada's GCRs by addressing the options for the federal-GCR relationship.

RETHINKING THE FEDERAL-GCR INTERFACE

Recent Federal Initiatives

In the 2004 federal budget, Finance Minister Ralph Goodale outlined a series of rather remarkable fiscal initiatives directed towards cities:

- rebates for GST and HST taxes paid on the provision of municipal services and community infrastructure, estimated to be worth $7 billion over ten years;
- accelerated funding of the $1 billion Municipal Rural Infrastructure Fund, with spending to be now undertaken over the next five years instead of the next 10;
- a commitment to work with the provinces to share a portion of gas tax revenues with cities or to introduce other fiscal mechanisms that achieve the same goals.

Of even more significance in the 2004 budget were the various jurisdictional measures:

- appointment of a parliamentary secretary (elevated to Minister of State for Infrastructure and Communities after the 2004 election) to lead federal efforts to obtain a new deal for communities;
- creation of the External Advisory Committee on Cities and Communities (chaired by former Vancouver mayor and former B.C. premier Mike Harcourt);
- participation of municipal representatives in federal budget consultations;
- a promise to give municipalities a stronger voice in shaping federal programs and policies that affect them.

Most appropriately, Goodale hailed these initiatives a "historic commitment to forge a New Deal for Canada's communities" (Goodale 2004, 165).

In the federal budget of 23 February 2005, Goodale detailed the manner in which Ottawa would share a portion of its federal gasoline tax with Canada's communities. Like most other spending items in the 2005 budget, this tax sharing was backloaded – rising from $600 million in fiscal 2005–6 (the equivalent of 1.5 cents per litre of gas tax revenues) to $2 billion in 2009–10 (or 5 cents per litre), for the promised $5 billion over five years. Since the 2005 budget continues with the New Deal label for these programs for cities and communities, one would assume that the 5 cents per litre in 2009–10 will be carried forward to future years as well, but there appears to be no direct commitment to this effect in the 2005 budget.

While the GCRs lobbied for the federal gas tax sharing to go preferentially to large cities, this was not to be the case. The first two principles underpinning the New Deal made this abundantly clear: "Provide municipalities, both large and small, with a long term, reliable and predictable source of funding"; and "Ensure equity between regions and between large and small communities" (Goodale 2005, 199). Not surprisingly, "to ensure that gas tax revenue allocation results in stable, predictable and equitable funding, the Government will allocate funds to the provinces, territories and First Nations on a per capita basis, with a minimum amount of funding assured for the smallest jurisdictions equal to 0.75 percent of total funding or $37.5 million over five years" (ibid., 204). These monies will be allocated in line with the following objectives and priorities:

> Eligible investments will include capital expenditures for environmentally sustainable municipal infrastructure. As the needs of large urban centres are different from those of smaller communities, eligible projects will depend on the size of the community and the region. In each large urban centre, investments will be targeted to one or two of the following priorities: public transit, water and

> wastewater, community energy systems, and treatment of solid waste. In smaller municipalities, eligible funding will be considered more broadly to provide flexibility to meet priorities. In all municipalities, some funds may also be used for capacity-building initiatives to support sustainability planning. (ibid., 204)

It is fair to suggest that Ottawa's New Deal for communities is not the constructive step forward for federal-GCR relations that Canada's larger cities had hoped for. Ottawa's penchant for redistribution and equalization was too strong to allow the privileging of Canada's GCRs. This is surprising, since there was a recognition of the role of GCRs in advancing a culture of innovation and enhancing our competitiveness and living standards. Paul Martin had himself championed the role of GCRs in the new global order well before he succeeded Jean Chrétien as prime minister.

A bolder federal vision for GCRs could have taken as its basis a proposal penned by the late Tom Plunkett and aptly entitled "A Nation of Cities Awaits Paul Martin's 'New Deal': Federal Funds for 'Creatures of the Provinces'":

> Does the mere fact that a province utilizes its powers to establish cities and other forms of local government mean that the province is required to monitor or participate in every relationship that its cities may have with the federal government? Most provinces are not that much interested in their largest cities. Their primary municipal interest seems to be in the small towns and rural areas. Can a province not simply agree to permit its largest cities to work out revenue sharing or other arrangements with the federal government? Some examination of these questions might lead to the possibility of a realistic and productive federal/city relationship. (2004, 23)

In terms of what would presumably have qualified as a "realistic and productive relationship" from the GCRs' perspective would, as noted earlier, be sharing a portion of the personal income tax on a derivation basis (as in Germany or Sweden) on the revenue side; or, on the expenditure side, participating in an infrastructure fund dedicated to addressing mass transit and logistics challenges.

Yet Ottawa failed to step up to the plate. Rather, the recent fiscal initiatives have actually discriminated against the GCRs relative to smaller cities and rural communities. A more apt headline for recent federal initiatives might be "A Nation of Villages Awaits Paul Martin's New Deal for Equalization and Regional Development." For example, the ratcheting up of equalization payments, with 3.5 percent indexing over the next ten years, resulted in new money for equalization totalling $33.4 billion – surprisingly close to the additional $41.3 billion allocated to health. And in the 2005 federal budget, Ottawa allocated a further $800 million to regional development as well as providing enhanced access to EI benefits, complete with their regional preferences relating both to accessing benefits and to the duration of payments. Indeed, as discussed later, Ottawa's New Deal as it relates to the gas tax is, in effect, yet another equalization program, this time effectively transferring funds from GCRs to municipalities. The reality remains that Ottawa continues to view GCRs as an ideal place from which to redistribute.

Other Federal Linkages

These budget initiatives will serve to refocus the GCRs' attention on their respective provinces, but as we shall see in the next section, our GCRs will nonetheless continue with their lobbying activities in the corridors of federal power. High on the GCRs' agenda should be the creation of a dedicated infrastructure fund along the lines already existing in the United States, and cast politically to be the counterpart of the regional development programs. To be sure, the Canada Strategic Infrastructure Fund goes some way towards this objective and could serve as a model for addressing the GCRs needs in terms of areas such as mass transit; but the most obvious avenue for the GCRs to pursue would be to seek full cost-recovery for expenditures undertaken in connection with their implementation of federal policy initiatives, particularly those relating to immigrant and refugee settlement costs. While Ottawa does have a program in place that contributes to these services, the allocation of funds bears little relationship to where immigrants and refugees locate. For reasons of both equity and efficiency, Ottawa should bear the full cost of these payments and should transfer them through the provinces to the GCRs on an equal-per-newcomer basis. Relatedly, Canada needs better policies and programs to recognize the newcomers' training and credentials in order to respond "to the growing recognition of the enormous waste of immigrants' human capital in Canada" (Alboim, Finnie, and Meng 2005, 20). Not only would such a policy have to be directed primarily to GCRs, but enabling immigrants to obtain the credentials needed to apply their knowledge or ply their trades would serve to improve Canadian GCRs' scores in terms of Florida's "3 Ts" and, as a result, our competitiveness in NAFTA economic space. If Ottawa wants to foster a closer relationship with Canada's major cities, removing this funding inequity and inefficiency is an excellent place to start.

Summary

The political and economic implications of the KBE are such that some version of the New Deal was bound to find the light of legislative day. Moreover, it is likely to be viewed as a successful initiative on many fronts. Cities welcome the invitation for consultation with Ottawa on policies related to Canada's communities. Given that the proceeds of the sharing of the federal gas tax will help develop environmentally sustainable municipal infrastructure, this measure will find support in the environmental community as well. Ottawa benefits because the gas tax transfer enhances the visibility of the federal government; and in the process, some progress has been made towards increasing the revenue autonomy of cities. Plaudits all around, or so it would appear.

However, as already noted, Ottawa's New Deal for communities is not the creative federal-GCR relationship that Canada's largest cities had in mind. The best light that the GCRs can put on this is that federal politics are such that Ottawa probably had to begin its relationship with cities by treating all cities in a similar manner. The reasoning would presumably be that only when the federal-city relationship develops further could the GCRs expect to receive special treatment. Yet pinning too much in the way of effort and aspirations on an improving federal-GCR relationship may be a questionable gambit for at least two reasons. The first is that while the Plunkett assertion that some provinces "are not much interested in [their] cities" may be traditional wisdom, the mere fact that the GCRs are actively lobbying Ottawa will hardly be lost on the provinces. Apart from the fact that the provinces may now be more receptive, the second reason is that the constitutional reality is such that the GCRs are eventually going to have to deal with or through their respective provinces. This being the case, we now turn our attention to the provincial-GCR relationship.

RETHINKING THE PROVINCIAL-GCR INTERFACE

At one level, the provinces are obviously fully on the side of their GCRs. Consider, for example, Ontario's 1999 "economic mission statement." As part of the province's commitment to "build on the potential of Ontario's city-regions," the mission statement asserts:

> Around the world, cities are the focal points for creativity, innovation, production and the supporting infrastructure. Ontario's seven largest urban areas account for 70% of all jobs in the province and will continue to be central in all economic development strategies ...
>
> Priority attention [must be directed] to the economic challenges and opportunities facing the Greater Toronto Area and surrounding Golden Horseshoe – Canada's only global scale city-region. (Ontario Jobs and Investment Board 1999, 64)

Presumably one can find similar rhetoric about Montreal, Vancouver, Calgary/Edmonton, Winnipeg, and others from their respective provincial governments.

At another level, however, the provinces have heretofore largely failed their GCRs, and cities generally. Whereas Ottawa has to go "through" the provinces to deal with the GCRs, the provinces have always been free to deal with them directly and as they see fit. For example, it has always been open for the provinces to privilege their GCRs by allocating a share of sales taxation or personal income taxation to cities on a derivation basis. Yet the reality is that the very opposite has occurred. As the earlier evidence indicates, Canadian cities are among the most fiscally constrained cities in the world. Indeed, it was this reality that encouraged cities to take their concerns to Ottawa in the first place.

The further reality is that the provinces have been backed into a fiscal and political corner by both Ottawa and their own cities. With respect to Ottawa, the provinces have been caught in the fiscal vise of "hourglass federalism," as elaborated earlier. And in this fiscally constrained environment, the GCRs and cities backed their respective provinces into a political corner by openly lobbying for a stronger fiscal and political relationship with Ottawa.

The upshot is that the provinces have begun to mount a counterattack. On the political front, they responded to Ottawa's plan for direct consultations with municipalities by proposing that cities participate, where appropriate, in the meetings of the Council of the Federation, and that the premiers would then carry the cities' concerns to the first ministers' table. While it is surely unlikely that the GCRs would view this as adequate compensation for refusing Ottawa's offer, it nonetheless opens the door to a broader range of interactions with the Council and, perhaps more importantly, with their respective provinces.

On the fiscal front, the move by Manitoba to transfer some of its own gasoline tax to its cities (in the pre-2004 budget period when Ottawa decided to postpone its proposed gas tax transfer) arguably was an important signal to all provinces. Ontario's response to the eventual transfer to cities of 5 cents per litre of the federal gas tax was to transfer 2 cents per litre of its own gas tax to cities. The allocation of this tax across the province's cities and municipalities is as follows: 30 percent on the basis of population and 70 percent on the basis of public transit ridership. Thus, while Ontario will likely allow the federal tax sharing to be determined in accordance with Ottawa's guidelines, its own gas tax allocation will proportionally favour the larger cities.

But provinces should go further with tax sharing in order to address the GCRs' pressing need for own-source revenues that will grow with the economy. The obvious options here are provincial sales taxes and income taxes. Likewise, the appropriate initial approach to sharing either of these revenues is via revenue sharing rather than tax-base sharing, with the share of revenues allocated on a derivation basis (see the appendix). While this would be a significant shift in terms of the fiscal evolution of cities, it would not be all that dramatic in dollar terms, since the sharing could, in the initial years, replace a given portion of provincial-municipal cash transfers. An alternative approach, one that may be preferable initially, would be for the province to index existing provincial-municipal transfers to the rate of growth of, say, provincial personal income taxes, an approach that held sway in Ontario during the 1970s (Sewell

2005b). This caveat aside, some province will surely at some time be enticed (or forced) into sharing its growth taxes with its cities and municipalities, perhaps with an accompanying municipal equalization program if per capita differences become too large. The game will then be afoot.

For this to occur, let alone be sustained, there need to be structures and processes to facilitate such privileged status for the larger cities. That this may not come easily is clear from the ongoing Ontario experience. Recently, the Ontario government signed a memorandum of understanding with the Association of Municipalities of Ontario (AMO) to consult with it on any legislation, regulations, and negotiations with Ottawa that affect municipalities. Toronto mayor David Miller objected to this because Toronto, as the sixth largest government in Canada, should be consulted directly and not via the AMO which, Miller points out, is not even a government (Campbell 2004). Indeed, Toronto has threatened to withdraw from the AMO, and the AMO in response is threatening to move its upcoming conference out of Toronto. From the perspective of the foregoing analysis, two observations are in order. First, it was only a matter of time before the GCRs-municipalities confrontation would develop. Second, the provinces will find it difficult not to provide formal or informal recognition of the special nature of GCRs. John Sewell (2005a) notes that the City of Toronto has recommended that Ontario adopt a consultation model similar to that in Alberta, where the provincial government consults with Calgary and Edmonton and with municipal associations, recognizing that these two cities are different from the other municipalities. Toronto suggests that Ontario conduct separate consultations with Toronto and perhaps some other large cities, in addition to its consultations with the AMO. While this would represent the beginning of a provincial-GCR interface in Ontario, it would not be the final word, because the GCRs ultimately want more legislative powers.

THE GCRs AND THE FISCAL IMBALANCE ISSUE

Readers will recognize that the demand for more powers on the part of GCRs has a very familiar federal ring. And so it should, for many of the traditional federal-provincial issues are now going to be replayed at the provincial-municipal level. From the vantage point of the GCRs, there is also a fiscal imbalance in the GCR-provincial relationship which they want rectified by, say, receiving a tax-point transfer from the provinces. They do not want to settle for additional equal per capita intergovernmental transfers from their respective provinces, since that would exacerbate their fiscal problems relative to both the provincial government and other municipalities. This is because the per capita value of sales and income tax revenues is higher in the GCRs than in other municipalities. To “send” this money to the province and then receive it back in equal per capita grants clearly disadvantages the GCRs.

Much more preferable would be the transfer of an equivalent value of sales or income tax room to the GCRs.

This is precisely the argument that Ontario's Dalton McGuinty is making to the federal government. Ontario, McGuinty notes, is contributing $23 billion more to the federal coffers than it receives in federal spending and transfers. Part of the McGuinty argument is that Ontario contributes more than its population share of federal revenues, so when Ottawa turns round and transfers these back in terms of equal per capita revenues in areas of provincial jurisdiction, this is tantamount to yet another equalization program. Hence, the frequent call for Ottawa to transfer additional income tax points to the provinces, which would then be equalized through the formal equalization program. The provinces would surely be willing to allow this income tax transfer to "pass through" to selected spending areas, in the same way as they likely will allow the gas tax to pass through. In any event, the point here is that our long-standing federalism debates will progressively be replayed at the provincial-GCR/city level.

Arguably, in at least one dimension Toronto may find it easier to make its case with Queen's Park than Queen's Park has been able to do with the federal government. Specifically, the operative assumption in the federation and embodied in the equalization program is that a given level of per capita revenues provides an equivalent level of public goods and services across all provinces. In other words, there is no recognition in the equalization formula that one should take the cost of providing services (i.e., capitalization) into account when assessing fiscal adequacy. As a relevant aside, in some recent exploratory work, I showed that taking into account the costs of providing public goods and services would leave Ontario with the lowest effective fiscal capacity of all provinces (Courchene 2005). It appears, however, that in terms of Toronto (or GCRs generally) there is a growing recognition that they require greater revenues than the smaller cities, both because of the range of their responsibilities and because we all benefit if they can be competitive with their U.S. counterparts. Given that the GCRs themselves also recognize this, the stage is set for some much bolder thinking by our global city-regions.

GCRs AS CITISTATES

The thrust of the foregoing analysis is that Canada's GCRs desire and require much more revenue and expenditure autonomy. Phrased differently, they want a more formal role in the operations of Canadian federalism. Moreover, not only are they acquiring the coordination and management capacity to undertake a broader range of functions and responsibilities than their smaller sister cities, but they are also approaching the critical mass of civil servants needed for them to become competing policy centres vis-à-vis their respective provincial governments with respect to the design and implementation of GCR policies. Finally, given that Ottawa looks after medicare as well as income support for children and the elderly, Canadian GCRs have much more room than their American counterparts to manoeuvre on the allocative or efficiency front without compromising the social fabric. So why not attempt to follow in the footsteps of the German city Länder (Berlin, Bremen, and Hamburg) and seek to become Canadian city-provinces with full constitutional powers? Toronto has not quite gone this far, at least not yet. But it has adopted a blueprint for a bold future within the federation – the Greater Toronto Charter:

The Greater Toronto Charter

Article One The Greater Toronto Region form an order of government that is a full partner of the Federal and Provincial Governments of Canada.

Article Two The Greater Toronto Region, and its municipalities, be empowered to govern and exercise responsibility over a broad range of issues, including:

child and family services; cultural institutions; economic development and marketing; education; environmental protection; health care; housing; immigrant and refugee settlement; land-use planning; law enforcement and emergency services; recreation; revenue generation, taxation and assessment; transportation; sewage treatment; social assistance; waste and natural resource management; and water supply and quality management, with the exception of those matters as are mutually agreed upon with other levels of government that are best assigned to another level.

Article Three The Greater Toronto Region have the fiscal authority to raise revenues and allocate expenditures with respect to those responsibilities outlined in Article Two.

Article Four The Greater Toronto Region be governed by accessible, democratic governments, created by their citizens and accountable to them for the exercise of the governments' full duties and responsibilities.

Article Five The Greater Toronto Region continue to fulfill its obligation to share its wealth, innovation and other assets with the rest of Canada, through appropriate mechanisms developed in concert with other levels of government.

Guided by two fundamental principles of democracy – subsidiarity and fiscal accountability – the citizen-initiated and citizen-drafted Greater Toronto

Charter has been endorsed by business leaders, community activists, former politicians, journalists, and academics and was enthusiastically received by the Committee of Greater Toronto Mayors and Regional Chairs. While city charters are not particularly novel in Canada – Vancouver, Winnipeg, Montreal, Saint John, and Newfoundland's two major cities all have them – the timing and breadth of the Toronto charter are significant; its timing coincides with the resurgence of cities and particularly the GCRs, and clearly the starting point of the charter is to view Toronto (or the GTA) as an order of government that is a full partner of the federal and provincial governments. Much of the rest of the charter follows rather axiomatically from the operations of federalism. Specifically, under the provisions of the charter, the GTA would aspire to:

- acquire, along the lines of the principle of subsidiarity, both exclusive and shared or concurrent powers/responsibilities;
- achieve fiscal autonomy with respect to both revenues and expenditures;
- be democratically accountable to its citizens;
- work with other governments to integrate the GTA, politically and economically, into the workings of the Canadian federation.

Even without providing further details, it is clear that this charter is, in principle, much closer to the concept of a city-province than it is to Toronto's status quo.

While there are some important advantages of the informal charter model over a formal (that is, constitutionalized) citistate model (for example, the appropriate boundaries of a Toronto city-province would probably need to be defined once and for all), the citistate model nonetheless represents an important reference point for many of the issues addressed in this paper. For example, under a citistate model, the GCRs would automatically retain more of the revenues generated within their boundaries. As already noted, since our GCRs will be competing head-to-head with American GCRs more than with Canada's smaller communities, it is essential that they have revenue and expenditure autonomy adequate to this task. This is especially so because the higher level of business activity in GCRs tends to be capitalized into higher wages, rents, and the like, so the GCRs need more revenues per capita than smaller municipalities in order to provide the same amount of public goods and services. Moreover, the fact that citistates are a viable model in the German federation provides additional leverage to Canada's GCRs in pressing their case with both Ottawa and the provinces.

However, there is a major concern associated with both the citistate and the charter model, even beyond that relating to political feasibility. It is that despite the merits of the model, there is precious little that the GCRs have done to earn this degree of power and autonomy. The most obvious issue here is that most of Canada's GCRs have shown little interest in accessing the untapped revenue sources that lie within their jurisdiction. By wanting to run before they learn to walk, the GCRs are in effect calling their own bluff in terms of their aspirations to become charter cities, let alone citistates or city-provinces. Nonetheless, the very presence of the charter, as well as the existence of the German city Länder, may serve to propel GCRs' actions more in line with their aspirations.

CONCLUSION

The tandem of globalization and the information revolution have catapulted global city-regions into the policy limelight. Because of their role as the dynamic export and innovation platforms of the new economy, their future is Canada's future. Hence, we need to find ways – politically, institutionally, and perhaps eventually constitutionally – to accommodate our GCRs' needs in the KBE. As Bradford points out, this may not be easy: "The concern here is that Canada's national policy machinery and intergovernmental system remains ill-adapted to changing policy realities and spatial flows. While governments at all levels are active in cities, there is little evidence of a coherent agenda, systematic coordination, or even appreciation of the importance of place quality to good outcomes" (2004, 40). Among other things, Bradford sees this challenge as involving "new thinking … that respects provincial constitutional responsibility for municipal governments while fully recognizing that metropolitan policy issues, from the environment and housing to employment and immigration, transcend the jurisdictional compartments" (ibid., 41). More optimistically, Bradford goes on to note that "using a mix of principles, programs, and networks, the EU in the 1990s developed multi-level governance to implement more place-sensitive policies and programs" (ibid., 43). The lesson that we ought to draw from this is that if the European Union can accomplish this multijurisdictional relationship within a multinational and even supranational context, it should be all the more easy to accomplish in a national context. Ottawa's most important role will be to provide the leadership so that the issue of what needs to be done is sorted out before attention turns to turf warfare or who does what.

The good news here is that Canadians have traditionally excelled at the art of federalism. We were able to centralize our fiscal system during wartime and then decentralize it again. We were able to create decentralized yet national programs in health, education, and welfare. We were able to accommodate Quebec's interests in terms of several national programs, including personal income taxes and the Canada/Quebec Pension Plan. Through changes in the magnitude of and incentives within the transfer system, we were effectively able to alter the division of powers between Ottawa and the provinces. And we did all this without any change in the *Constitution Act,* *1867*. Rather, we did it through creative instruments and processes – the federal spending power, opting out, altering the nature of federal-provincial transfers, cost sharing, delegation of powers, and the like. Jean Chrétien's Team Canada missions and the provinces' Council of the Federation are more recent examples of these creative instruments and processes at the national and provincial levels, respectively.

In short, if there is a societal will, there is a federal way. Since our collective future economic and social well-being depends on the success of our GCRs, Canada and Canadians will find a way to ensure that our global city-regions become more fully and more formally integrated into the operations of Canadian fiscal and political federalism.

APPENDIX: ANALYTICAL PERSPECTIVES ON TAX SHARING

SHARING TAX REVENUES

There are at least three features of tax sharing that need elaboration. The first has to do with whether the cities are *sharing the revenues* from a given tax base or whether they are *sharing the tax base* itself and therefore have the freedom to alter the tax rate. For example, under the former, the cities would presumably receive a fixed share of the revenues collected by the relevant senior government (for example, a given percentage, or a given number of the eight percentage points of Ontario's PST, or in the case of sharing the federal gas tax, a given number of cents per litre). Under tax-base sharing, however, Ontario would, for example, reduce its provincial sales tax rate from 8 to 6 percent and then allow cities to take up the tax room by setting their own rate, say between zero and 4 percent. This latter version would give the cities tax-rate flexibility and therefore would allow them to determine their own revenues at the margin.

The second issue relates to the *allocation* of the shared revenues. For example, the proceeds of revenue sharing for the cities could be allocated according to the "derivation principle" (in accordance with where revenues are derived from in the first place) or in some other manner (for example, equal per capita). For such taxes as the multilevel GST, for which it can be difficult to ascertain geographically where the revenues actually come from, allocation would probably have to be done on a basis other than the derivation principle. It is far easier to allocate shares of a gasoline tax or a PST on a derivation basis (by quantity of gas sold in a given location or by the location-related PST-eligible final sales, respectively), though they could also be allocated on an equal per capita basis. Typically, when taxes are allocated on the derivation principle, richer (and generally larger) cities receive greater per capita revenues, so pressures might develop to supplement this by some sort of equalization program.

The third issue relates to the nature of shared revenues – should they be conditional (earmarked) or unconditional? For example, the revenues from the proposed gasoline tax are intended to be earmarked for transportation infrastructure, making them more like a "benefit" tax or a user fee. If revenues from GST or PST sharing are made conditional, this will presumably have less to do with efficiency than with attempting to ensure that cities carry out the preferences of the donor government. Obviously, fiscal autonomy is enhanced when revenues are transferred to cities without any conditions in terms of how and where they are spent.

Not surprisingly, there is a relationship among these three issues. For example, allowing provinces to set their own tax rates (on a federally or provincially determined tax base) leads rather naturally to the allocation of the resulting revenues on a derivation basis, as well as favouring unconditionality in terms of how these revenues are to be spent.

INTERGOVERNMENTAL TRANSFERS AND REVENUE SHARING

The second role of this appendix is to compare revenue sharing with traditional transfers. Motivating this analysis is the TD Bank's assertion (quoted in the text) that federal and provincial grants should be used to address cities' accumulated funding shortfalls – but they are the wrong vehicle for financing cities' ongoing financial needs. Presumably, one of the reasons for this claim is that intergovernmental grants or transfers are open to arbitrary change (for example, the CHST cuts) or are subject to arbitrary "conditioning." Moreover, they are unlike tax-base sharing, which allows cities to increase or decrease their revenues at the margin.

However, it is possible to make too fine a distinction between revenue sharing and intergovernmental grants. Consider the following two examples. The first draws from actual experience in Australia, namely, the operations of the Commonwealth Grants Commission (CGC). Recently, the Commonwealth government and the Australian states agreed that: (a) a new 10 percent value-added tax called the GST will be introduced and collected by the Commonwealth government; (b) the 10 percent tax rate cannot be changed without agreement of the Commonwealth and all of the states; (c) the *entire proceeds* of the GST are to be transferred to the states; (d) these revenues will be "equalized" for both revenue means and expenditure needs via the operations of the Commonwealth Grants Commission; (e) the resulting grants are unconditional; and (f) the GST replaces a series of pre-existing state taxes that cannot be reintroduced. In terms of the three issues alluded to above, one would (presumably) refer to this as tax sharing (but at a 100 percent rate), with the proceeds being allocated under the equalizing provisions of the CGC and where the resulting revenues are unconditional. As a relevant aside, the Australian states are particularly delighted with one feature of this system –

not only is the GST a broad-based tax but it is growing faster than GDP, so aggregate state revenues are rising as a percent of GDP. One of the themes of this paper is that Canada's cities too need access to a growing tax base.

Now compare this to another example. Suppose the federal government were to initiate annual grants to the cities of, say, $4 billion, escalated annually by the rate of growth of federal GST revenues. Assume that these grants would be unconditional and allocated to cities on an equal per capita basis. Since $4 billion annually is roughly equal to one percentage point of the GST (and over time would remain at roughly one percentage point given the nature of the indexing), this is not all that different from the above Australian revenue-sharing example. In other words, there would appear to be enough flexibility in terms of the design of intergovernmental transfers to replicate most features of sharing the revenues of a tax base. This is especially the case if creative ways are found to ensure that these transfer arrangements could not be altered arbitrarily by the donor government.

NOTES

This paper "appropriates" the title of a book by Neil Peirce (1993). My thinking on city issues had its origins in a series of discussions with then-president of the C.D. Howe Institute, Tom Kierans, who encouraged me to extend my work on federalism to incorporate cities and especially what are referred to below as global city-regions. In the present context it is a pleasure to acknowledge the comments and encouragement from Robert Young. Thanks are also due to France St-Hilaire and Jeremy Leonard of IRPP for many valuable organizational and substantive suggestions on earlier drafts. I also wish to acknowledge the support from the SSHRC Major Collaborative Research Initiative (Multilevel Governance).

1 In a recent *Globe and Mail* column, Jeffrey Simpson (2005) noted that government spending in British Columbia over the last four years and the next four is forecast to increase by $2.7 billion. Health-care expenditures over the same eight years are also forecast to increase by $2.7 billion. This is hourglass federalism at its finest!

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