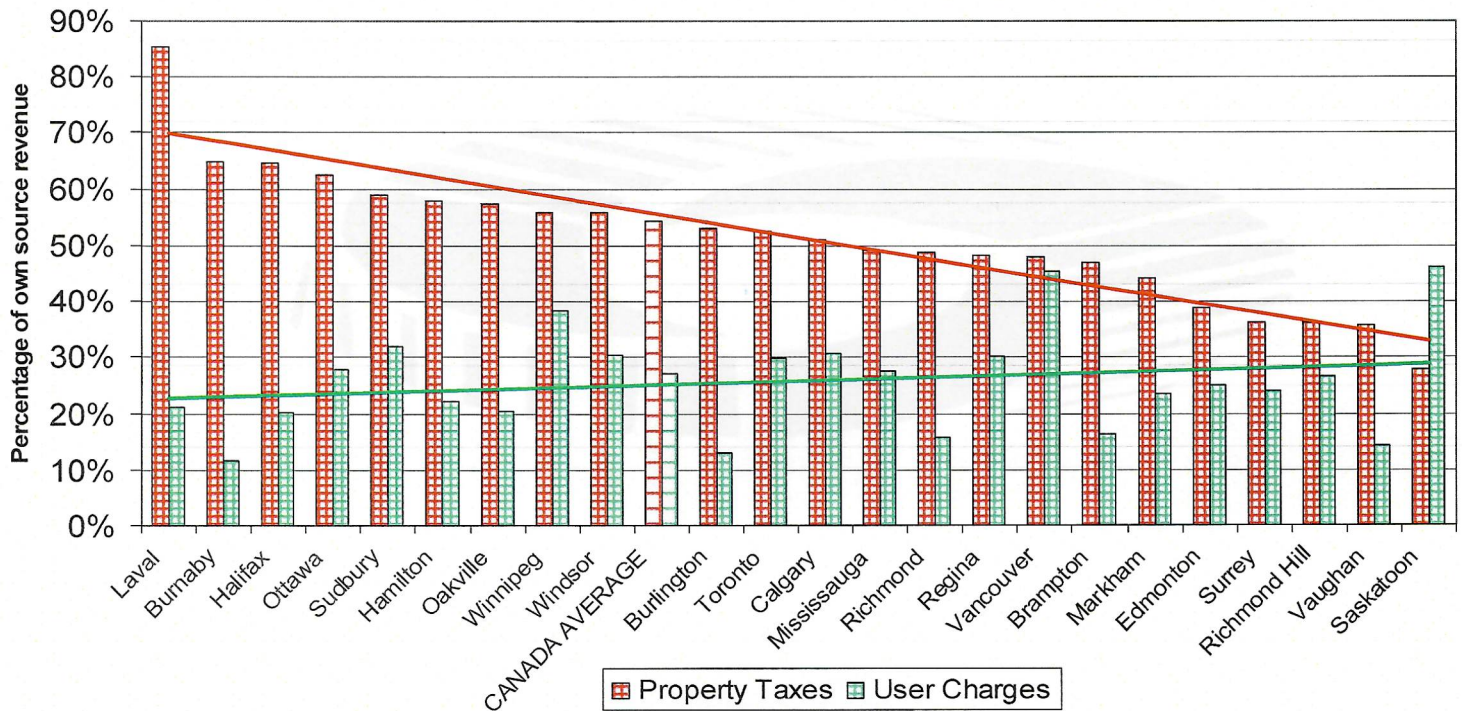


Taxes or User Charges?

A question of best practice for municipal funding.

Like all governments, municipalities have the option of using a number of revenue-raising tools that have different characteristics. This Frontier Charticle examines the use of property taxes versus user charges for the funding of municipal services. The graph below shows taxes and user charges expressed as a percentage of total own-source revenue.

Property Taxes and User Charges/Household



The evidence of the Local Government Performance Index research (above) is that there is an inverse correlation between property taxes and user charges. Not surprisingly, greater use of one means less use of the other, with the Canadian average at a 2:1 ratio.

Property taxes impose the municipality's costs upon all residents. Their principal disadvantage when compared to direct user charges is that they do not possess the market-related feedback of the residents' demand for municipal services. User charges have the advantage that they reveal the residents' true preferences by municipalities delivering only what their residents are prepared to pay for. However, they may not fully take into account some residents' inability to pay for services. While the composition of revenue between taxation and user charges is ultimately a classic equity-efficiency trade-off for which there is no one right answer, it is instructive to look at the Canadian data and international trends.

- Between 1976 and 1996, U.S. taxes dropped from 76% of total revenue to 70% (U.S. Federal Authority)
- In New Zealand, property rates fell from percentages in the mid-50s to 47% by 2006 (Base Stats)

The trend is toward greater use of user charges. However, this move to more user-pay funding is only possible if accountability derived from reliable information regarding the costs of municipal services is available. In the absence of adequate financial information, taxes often become the default option, transparency and accountability suffer, and the market rationing of the supply and demand in municipal services is lost.

International experience suggests that Canadian municipalities have the opportunity to make greater use of user charges and thereby to increase overall value for money from the residents' point of view. More desirable levels of user charges will only be possible when cost and asset management information improves to a point where the true costs, including asset debt servicing and depreciation associated with the provision of most municipal services, can be properly recorded and passed on.

Sources: U.S. Federal Data accessed at <http://www.ncsl.org/programs/fiscal/fpufmain.htm#user> Base Stats accessed at <http://www.kauriglen.co.nz> chart data from 2007 Frontier Centre Local Government Performance Index, available www.fcpp.org.