Sustainable Solutions for Montréal

January 31, 2007

(rev. February 2007)

Montréal

Introduction

For several years, relations between the Ville de Montréal and the Québec government have been marked by the recurrent financial problems faced by the municipal administration. On the one hand, the city is required to make regular trips to Québec, bearing lists of financial or fiscal woes. Occasionally, the impasse becomes so serious that a bilateral agreement is concluded to resolve the most urgent crisis. On the other hand, the Québec government is trying to preserve a financial and fiscal framework that applies to the entire municipal world, with few exceptions, and wishes to avoid treating Montréal in a way that would cause frustration among the other municipalities and regions.

The Montréal administration and the Québec government have inherited this situation, which has arisen as a result of decisions taken over the last quarter century. These recurrent cycles of discussions, claims and piecemeal agreements have come to dominate relations between the city and the government, and have overshadowed the vital issues relating to the role which the metropolis must play in the development of Québec.

It is time to move to another stage in relations between Québec and its metropolis, between the government and the city, in order to mobilize the resources and energies of the two institutions towards development goals and projects rather than grocery lists. To do this, however, requires at the outset to establish an institutional, financial and fiscal framework that ensures stability and at least some margin of maneuver for the city.

Prerequisite: straighten the finances of the city

The 2007 fiscal year is a turning point of the Metropolis. As the law requires, the Administration has succeeded in adopting a balanced budget, with expenditures rising less than the rate of inflation. Also, as promised, the city has succeeded for the second year in a row to freeze the overall tax burden of Montréal taxpayers.

With an anticipated deficit of nearly $400 million at the beginning of 2006, reaching these objectives has required unprecedented measures: a freeze on hiring and expenses, on budgets of the boroughs and corporate departments, and on the remuneration of City Councillors. The city has also decided to proceed with a review of the activities, services, operations and programs (RASOP) to ensure that they respond to its essential mission as a city administration, and to reduce expenses as much as possible.

In all, this exercise will generate savings in the range of $300 million over three years. These are recurrent annual gains which will be repeated in subsequent years. Among the means for obtaining these savings: we plan to abolish 1,000 jobs, including 250 management positions, over the same period. These amounts appear modest, however, if they are compared to the city’s annual expenditures of nearly $4 billion. So it must be realized that contrary to popular belief, Montréal does not have anything near the margin of maneuver that critics say it does. Certainly, it is a huge machine, but it provides direct services to a population of 1,800,000 people. Almost half of its budget is for payroll, and more than a fifth is for debt service. What had to be done regarding the governance and expenditures of the city has thus been done.

Worrisome projections

As part of the preparation of the 2007 Budget, the city has made projections of its financial situation for the next seven years (the duration of the fiscal and financial agreement between Québec and its municipalities for the years 2007 to 2013).

The conclusion of this exercise is that, even taking into account the revenues generated by this agreement with Québec, even by integrating the savings from its review of activities, services, operations and programs, even by taking into account the financial structure of negotiations for a wage freeze in 2007 and increases of 2% in subsequent years, there will be a major shortfall between revenues and expenses for this entire period.

The projections also show that by indexing the property tax to the projected inflation rate (2%) as of the 2008 fiscal year, the city can strike a balance between revenues and expenses over this same period.

At first glance, this suggests that the city has solved a good deal of its historic and recurrent financial problems, thanks to good management and budget discipline.

However, this budgetary balance does not taken into account the investments required to ensure the renewal and repair of Montréal’s infrastructure, the adaptation of certain services to meet new government standards, and the investments required to support the economic development and recovery of Montréal.

Taking into account all of these issues, there remains a shortfall, which will increase from some $276 million in 2008 to about $600 million in 2013. The largest part of this amount represents investments which must be paid in cash, to avoid creating new debt for future generations. This amount also takes into account the additional revenues related to the plan Imagining - Building Montréal 2025, which are in the range of $80 million.

Unless the resources are found to deal with these major challenges, Montrealers will be faced with an accelerated deterioration of public infrastructures, which will, eventually, have to be urgently repaired or replaced, at much higher cost and inconvenience to Montrealers and Montréal businesses.

Remember that when things improve in Montréal, they also improve in the rest of Québec.

To meet these needs within the resources of the existing municipal fiscal plan, the city would have to impose repeated property tax increases, far beyond the rate of inflation. These heavy blows to Montréal taxpayers (individuals or businesses) would cause many to leave the city, and discourage many others from moving to Montréal. In short, while seeking to slow the deterioration of our public heritage and encourage the development of Montréal, we would instead contribute to accelerating the decline and shifting the burden of necessary investment to an even smaller base of captive taxpayers, and to future generations.

Exceptional assets

Does this mean that we must accept the erosion of the heritage of Montrealers? How did we reach this situation where achieving a balanced municipal budget compromises both existing assets and future development prospects of the metropolis?

Things are not so bad in Montréal, in fact. The economy has achieved an impressive turnaround over the last 15 years. Many of our businesses in traditional “soft” sectors have modernized, while others have been replaced by innovative new enterprises in lively growth sectors. The Montréal economy is going through a remarkable process of adaptation to global competition, and today can rely on one of the best educated workforces in the world. Our knowledge institutions are the envy of most of the world’s cities of similar size, and put Montréal near the head of the class in North America in terms of research and development. Furthermore, our city is recognized as one of the world’s leaders in terms of quality of life, cultural vitality, and safe streets and neighbourhoods. Montréal real estate is enjoying respectable growth.

However, little of this is reflected in the somber picture of the city’s budget projections for the coming years.

A fiscal regime that is unsuitable for Montréal

To understand this apparent dilemma, we have to look backwards, to when the Québec government established the current municipal fiscal regime.

In 1980, the government defined the essentials of the fiscal regime for municipalities and school boards, which have prevailed since that time. This reform rested on the basic principle that municipalities should draw their revenues mainly from their property and rental taxes. The government withdrew or limited their capacity to charge taxes on sales, meals, and hotel rooms, also amusement taxes and taxes on telephone equipment. At the same time, it abolished the per capita transfers which had until then been paid to the municipalities. In compensation, they were to increase their property and rental tax rates.

This reform had considerable impact on the city of Montréal. Overnight, nearly a fifth of its revenues were amputated, and it had to transfer this entire amount to general property tax and rental tax, which have since then been the primary source of independent revenues. This massive recourse may have been appropriate for small municipalities across Québec and the metropolitan region. However, it put Montréal into a fiscal straitjacket: a plan completely unsuited to the nature and extent of its responsibilities.

The main advantage of property taxes is to facilitate the matching of tax revenues to expenses and investments that are primarily for services considered to be for property – such as local roads, water and sewer systems, garbage removal, zoning and permits, etc. In the great majority of municipalities in Québec, this source of revenues is well suited to serving a relatively homogeneous population and supporting economic activities oriented to nearby markets or a small number of large exporting companies. In such a milieu, property wealth is a good indicator of the tax contribution which is reasonable to require from a taxpayer.

This is not the case in Montréal. The range of services offered by Montréal certainly includes basic services for property, although they must be planned and provided on a scale that is not comparable to that of any other municipality in Québec. Also, they must take into account the fact that its infrastructure, public facilities, and municipal services are used not only by its population, and its local enterprises, but also by users from the entire metropolitan region.

That is not all. The city must also adapt its activities and its investments to an urban reality which is unique in Québec. Services to the person therefore have a magnitude and complexity unknown elsewhere in Québec. Montréal is at the centre of an intense demographic, social, and cultural mixing bowl, whose conditions have repercussions throughout Québec.

Each year, tens of thousands of immigrants come to our city and integrate into Québec society. A roughly equivalent number of young people from across Québec and the metropolitan region come to pursue their studies or try their luck on the job market. Each year, by contrast, about the same number of people leaves Montréal, the great majority headed for the suburbs where they also nurture growth and dynamism. Overall, about one Montrealer in five will leave after five years, to be replaced by an equivalent number of newcomers from the regions, other provinces or abroad.

During this same period, many companies present at the outset will have been replaced by another cohort, with new jobs, that will change the nature and composition of the exchanges between the Metropolis and the world. Montréal is no ivory tower: it is in a close and continuous symbiosis with its region, with the rest of Québec, and with the world.

To deal with this intense intermixing, the city has to constantly adapt its priorities, its services, and facilities. Services to the person, which are in the urban setting often more to be seen as for the community, play a central role in maintaining social cohesion, sociocultural integration, professional insertion, and public security.

Without placing significant resources into prevention and development, Montréal would find itself rapidly facing problems with a much greater cost in repression and repairs.

The same applies to “services to enterprises”, which often become “services to the business community “. Montréal must take its place in a network of great cities of the continent and the world. The city must therefore pursue continuous efforts, with several partners including the government of Québec, to support the promotion and expansion strategies of its enterprises, from knowledge base to industrial space. Otherwise, it would face stagnation, along with the exchanges and the jobs that depend on it, and an even greater weight would drop on public resources than if we had acted earlier, and more effectively.

Today it is very clear, indeed, that this diversity of responsibility does not fit well into a monolithic fiscal plan which most of the municipal fiscal burden falls on property.

Passing the bill to the municipalities

Since 1980, the changes made by various governments to the municipal tax plan had one thing in common: not to adjust and improve the financial framework of the municipalities, but to contribute to the budgetary and financial strategies of the government of Québec.

Property tax exemptions for the government

First of all, the government has never delivered on its 1980 commitment to make the education and social services network fully taxable. This omission deprived municipalities – and singularly Montréal – of hundreds of millions of dollars of revenues. The government has simply lightened its contribution to these networks.

The remuneration of municipal employees

It is often said that municipal employees are overpaid. It is in 1982 that the variance in remuneration really began, when the government in power imposed a wage settlement. The municipalities did not have access to the tools to follow suit. The relative difference that emerged at that time has remained about constant. In the case of Montréal, this difference represents a recurrent amount of $150-200 million annually.

Position of the property tax field held by school boards

In 1980, to enable municipalities to increase their presence in the property tax field, the government put a ceiling on the school board tax rate of 25 cents per $100 of valuation. This ceiling rose to 35 cents per $100, encroaching on the tax room previously reserved for municipalities. This measure, presented as temporary, has not been removed since that time.

If Montréal still occupied the tax room that had been reserved for it at the outset, it would have access to revenues of over $80 million, without increasing the overall tax burden of Montréal property tax payers.

Transfer of responsibilities to the municipalities

In 1992, Bill 145 brought a major transfer from Québec to the municipalities of responsibilities and their need to be financed. Internal studies conducted by the Municipal Affairs and Regions Department revealed that there was unexploited tax room in the property tax field, so the government decided on a net transfer of $280 million dollars to the municipalities. The main financial element of that reform was an unprecedented withdrawal from the financing of public transport, which hit Montréal harder than any other municipality in Québec. According to department figures, Montréal taxpayers had to absorb a bill of $92 million, that is an additional cost of $90 per Montrealer, compared to $32 per resident in the rest of Québec.

Following this, other transfers were added to municipal budgets, further increasing the weight on property tax revenues. In 1997, the government required municipalities to make an additional contribution of $375 million, so that it could achieve a balanced budget. For the first time, however, the government recognized the special situation of central cities, including Montréal. Consequently, they were spared part of the transfers. Montréal taxpayers were only left with about $47 million more per year to pay, on that occasion.

Montrealers pay twice

But the special effort demanded of Montréal taxpayers does not stop there. Montrealers are, in effect, called upon to pay twice for some of the public services provided on the territory.

The case of specialized police services on the Island of Montréal is revealing. On the Island of Montréal, these services are provided by the Montréal Police Department, at an annual cost of $24 million. Elsewhere in Québec, the Sûreté du Québec (SQ) carries out this responsibility. Hence, while receiving the same service, Montrealers pay twice: once through their income taxes for the specialized services that the SQ provides outside Montréal; and a second time through municipal taxes for the services provided by the Montréal Police Department (SPVM) on the Island.

A similar situation prevails in student transportation, where Montrealers must pay for the student transport services of the Montreal Transit Company (STM) without any compensation from the Québec government. These services are subsidized by the government in other regions of Québec.

Another example, the Québec government pays local authorities annual amounts to support their involvement in welcoming and integrating immigrants. While Montréal welcomes some 70% of immigrants to Québec it receives much less than its share of these government transfers. This results, in part, from government effort to encourage the establishment of immigrants in the regions; but this policy penalizes Montréal. In concrete terms, Montréal receives $20 per immigrant planning to establish himself on its territory, while Laval receives $120 and Québec city $150. For Montréal, this represents an annual shortfall of approximately $5 million.

This shows that many sources of institutional imbalance and unfair taxation persist in Montréal, in comparison with other parts of Québec, and weigh heavily on the finances of the city and those of the Montréal agglomeration.

We must recognize that the government sometimes brings tangible financial assistance to the city, as was the case for the refinancing of the actuarial liability of the pension funds managed by the city. This financing generated significant annual savings for the taxpayers of the former city of Montréal, which will reach some $50 million per year between 2015 and 2045.

Modest regional sharing

Another problem is that Montréal taxpayers alone are required to pay for many facilities and activities that have metropolitan functions. This enables many suburban municipalities to benefit from their participation in the metropolitan region without paying their share of costs. They are free to use aggressive tax strategies to attract new households and new business.

The creation, in 2001, of the Montréal Metropolitan Community had raised hope. For the first time, a supramunicipal structure would cover the entire city region. However, with an overall budget of about $100 million, about 60% from the municipalities, the contribution of the Community to fair sharing of financial responsibility in the region remains very modest.

The other fiscal imbalance

The last 25 years have seen the establishment of, and many reforms to, a fiscal regime which has still not resolved the two main problems it is supposed to address.

1. Revenues in Montréal are too dependent on the property tax field and do not reflect the reality of its urban responsibilities. In particular, and unlike the great majority of comparable urban regions, the city has available only indirect and marginal mechanisms enabling it to tie its revenues to the economic and commercial activity on its territory.

2. The mechanisms for metropolitan financing remain insufficient to mobilize the resources to carry out the major regional functions, including public transit, and to guarantee an equal sharing of the burden between taxpayers and users of these services.

None of the measures put in place over the last 25 years have resolved either of these problems. Currently, Montréal simply does not have the resources needed to play its role in the urban space and to unload its responsibilities under its Charter and the municipal legislation adopted by the National Assembly.

Held in this fiscal stranglehold and subject to the problems of having revenues overly dependent on the property tax field, the city has been obliged, year after year, to put off investments to restore facilities and infrastructure for which it is responsible. Similarly, in the absence of resources, it decided not to intervene upstream in urban problems that it knows will degenerate and force later interventions that are even more costly.

To maintain a fiscal regime unsuited to its metropolis, Québec will ultimately have to pay a much higher price than the immediate resources required to let the city and its regional partners carry out their responsibilities. At stake is the development of Québec's main metropolitan centre.

Montréal and the regions

Many of Québec's resource regions are currently going through a difficult period of economic transition. Montrealers, many of them from those same regions, have parents and friends there, or do business there. They know the situation and feel a sense of solidarity. They do so with conviction, all the more since they remember the difficulties of the Montréal economy during the recession at the beginning of the 1980s, during the complete failure of some traditional industries, and when a number of tertiary activities abandoned the region.

As discouraging as those years of crisis were, they were also in fact years of transition. Alongside the modernizing traditional industries, a new generation of enterprises working in leading-edge sectors has now become the engine of a renewed metropolitan economy.

What was possible for Montréal over the past 25 years is also possible for the regions today, in their own way and at their own pace. Because they remember and feel solidarity, Montrealers can and must contribute to this effort. Montréal will not develop as the centre of an economic desert. It must contribute to the development and renewal of the regions. The Montréal market is a natural outlet for many enterprises throughout Québec. Montréal's exports may incorporate products developed, manufactured or assembled in the regions. Montréal provides a service to business which supports the economic development of the regions.

The public and private resources flowing from Montréal cannot really help to reinforce the regions unless the metropolis is itself able to pursue its development and face the competition of other, comparable great cities in North America or elsewhere in the world. However, at the present moment, unable to mobilize the minimum resources to take care of elementary responsibilities, the city is facing unhappy alternatives:

- Either it "pumps" the resources of the State on a case-by-case basis, setting itself up in an absurd and useless competition with the regions, which have their own very pressing needs.
- Or it resigns itself to a decline, which is totally unnecessary in economic terms, and which will have a major negative impact on its own development and that of all the regions.

The price to pay for maintaining a fiscal system that is unsuited to the metropolitan reality goes far beyond the immediate impacts, which are already felt significantly in the Montréal Budget.

Paths to solution

Given these facts, we must examine the possibilities carefully.

First, the city can choose additional budget cutbacks to balance its budget with indexing taxes. However, the cuts would affect services to the population. Furthermore, the city must slow down the essential investments in its infrastructure and leave assets for future generations. From time to time the city, deprived of its margin for maneuver, will have to solicit help from Québec to balance its budget in the case of unforeseen difficulty.

This solution does not stand up to analysis and leads Montrealers directly to a crisis which will, at best, slow down progress. The heritage of collective equipment and facilities and basic infrastructures of the metropolis continue to deteriorate in the absence of the necessary investments. Furthermore, the absence of significant investment in development would bring economic stagnation and aggravate social problems.

Another solution would be to index property taxes to the inflation rate. This would allow us to avoid cutting services to the population too vigorously, but would do nothing for the deficit in investments in infrastructure.

We could increase taxes beyond the inflation rate. This is where the question of Montréal's fiscal competitiveness compared to that of neighbouring cities comes into play. Montréal has made major efforts to reduce this difference in recent years. It is important to avoid having a larger tax burden that would encourage an accelerated flight of people and enterprises to lower tax rates in the suburbs.

A fourth avenue would be to ask more money from Québec, to compensate the city for the metropolitan effects. We need only think of premature wear on infrastructure, or specialized police services to work effectively against organized crime or control terrorist threats. However, this would put the city in competition with the regions as well as other fields of provincial jurisdiction, such as health, to obtain resources which the government does not provide elsewhere.

However, there are also more imaginative ways to improve the link between obtaining a service and how it is financed: ways that do not strike against the government's budget.

In the first place, we could imagine a formula by which the government would recognize the efforts made by Montréal to generate wealth and share its benefits. This is a win-win formula which does not penalize the financial structure of the government and which represents major incentive for encouraging the city to deploy all possible efforts, on a business basis, to increase the collective wealth, to the benefit of all regions of Québec. The opposite is also true. In the current fiscal system, many projects that are beneficial for Québec may never seeing the light of day because the city cannot support them financially; so the revenues which could have been generated will not be there for anyone.

Second, the government could give the city the power to give more latitude to the city in the fields of administration and finance. This would mean increasing the autonomy of the city, after the example of the City of Toronto, which has obtained such recognition from the Government of Ontario. By providing this increased autonomy, the government could explicitly exclude the fields of taxation which it wishes to reserve exclusively for itself.

With such powers the city could, for example, decide to rely more on the users of a service or facility to cover the burden of its financing. Several possibilities could be explored within this framework. With such a system, of course, the municipal administration would remain accountable for its own decisions to the voters and taxpayers for the political consequences of its decisions.

The city also remains open to any approach to a solution that comes from the government or the community. However, the matter is pressing, and the time has come for action, not reflection.

By subscribing to this new vision for its metropolis, the government of Québec would bring a new sustainable solution to the financial problems of Montréal. It could put an end to the annual trips the city has to make to balance its budget. It could see an end to the “grocery lists” which have too often characterized its relations with the city. In fact, these issues, which consume great amounts of energy, fall too often into impasse, which explains the recurrent financial problems of the city.

The Québec government has a historical opportunity to contribute to the recovery of its metropolis. By acting in this manner, the government will go far beyond a short-term fix. It will enable Montréal to ensure that it leaves the younger generation and those to follow a legacy and heritage of high quality, and prospects for development suitable to one of the most interesting and stimulating places in the world.