

**VIBRANT CITIES AND CITY-REGIONS:
RESPONDING TO EMERGING CHALLENGES**

**A paper prepared for
the Panel on the Role of Government**

by

Enid Slack, Enid Slack Consulting Inc.
Larry S. Bourne, University of Toronto
Meric S. Gertler, University of Toronto

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VIBRANT CITIES AND CITY-REGIONS: RESPONDING TO EMERGING CHALLENGES¹

As part of its mandate on “Healthy Communities: Investing in Social Capital,” the Panel on the Role of Government asked us to examine the role that the provincial government should play in responding to challenges faced by the province’s larger cities and city-regions (“Vibrant Cities and City-Regions”), on the one hand, and the different set of challenges faced by small, rural, and remote communities (“Communities at Risk”), on the other hand. This paper reviews the importance of vibrant cities and city-regions to the provincial economy and examines how to address the economic, social, and fiscal challenges they face. A separate paper examines the provincial government’s role in responding to the challenges facing smaller communities at risk (Small, Rural, and Remote Communities: The Anatomy of Risk).

This paper is divided into five sections:

- ∄ The first section reviews the importance of Ontario’s cities and city-regions to the provincial economy and explains why keeping cities and city-regions vibrant matters for the economic prosperity of Ontario and Canada. This section provides both an overview of the conceptual arguments around the importance of cities and a review of the data documenting the contribution of cities to the Ontario economy.
- ∄ The second section focuses on the challenges confronting Ontario’s cities, emphasizing the economic, social, and fiscal challenges.
- ∄ The third section outlines the current relationships between the provincial government and its cities and city-regions. These relationships are set out in the Municipal Act as well as in provincial initiatives such as local services realignment, provincial grants, municipal restructuring, and property tax reform.
- ∄ The fourth section considers the most appropriate form and level of government at the sub-provincial level for cities and city-regions. It sets out the criteria for designing government structure and then describes and evaluates four different governance models: two-tier, one-tier, voluntary cooperation, and special purpose districts.
- ∄ The fifth section summarizes recent economic, social, and fiscal trends in cities and city-

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regions and identifies some of the challenges these pose for provincial, sub-provincial, and municipal governments. It makes recommendations to enhance the ability of Ontario's cities and city-regions to respond to the challenges and improve economic competitiveness, social cohesion, and financial viability while augmenting the democratic process, maintaining political accountability, and improving the overall quality of urban life.

1 WHY CITIES AND CITY-REGIONS MATTER TO THE PROVINCIAL ECONOMY

Although it has become commonplace to assert that cities are the engines of the national or provincial economy, it is important to have a clear understanding of the basis for such claims. In this section, we review the importance of Ontario's cities to the provincial economy and discuss why keeping our cities vibrant matters for the overall economic prosperity of Ontarians, and indeed all Canadians. We approach this analysis in two ways. First, we provide an overview of the conceptual arguments and evidence concerning the growing importance of cities to national and regional economic competitiveness. Following this, we offer a brief review of the data documenting the contribution of Ontario's cities to the performance of the provincial economy.

1.1 The Role of City-Regions in the Knowledge Economy

The defining feature of market economies today is undoubtedly the fact that knowledge and learning have become predominant in the creation of economic value and the determination of competitive success (OECD, 1996; Lundvall and Johnson, 1994). There are several distinct dimensions to this transition that hold important implications for cities' role in the larger economy.

First, competition between firms is increasingly being waged on the basis of the qualitative characteristics of products (goods or services), and the ability to bring new or improved products to the marketplace quickly. Moreover, innovations in the production process are often just as important as product innovations, since they enable both the rapid shift to the production of new products and the attainment of quality standards and performance which consumers now expect. Firms that compete most successfully are no longer simply those that offer their product at the lowest price: rather, their ability to generate new product and process innovations in a timely and effective fashion has become equally, if not more, important.

Second, while major research institutions such as universities, public research centres, and corporate R&D facilities play a pivotal role in the production and dissemination of knowledge, it is now widely acknowledged that for economic actors, social processes of learning have become considerably more important (Lundvall, 1988; Gertler and Wolfe, 2002). This is based on the recognition that a large and growing proportion of innovation (broadly defined) occurs through the process of interaction between economic actors: for example, between technology

users/customers and technology producers, or through the collaborative interaction between partnering technology producers. The 'actors' engaged in these processes include private firms large and small, colleges and universities, stand alone research centres, technology transfer organizations, producers' associations, and other institutional forms.

It is important to point out that this phenomenon of learning-based innovation is equally important to the fortune of both manufacturing and service activities. Within Ontario's urban communities, there are no better examples of this than the Kitchener-Waterloo-Cambridge and Hamilton regions. In the former case, intensive interaction between the University of Waterloo and the firms around it have spawned and nurtured the development of highly innovative, knowledge-intensive manufacturers such as Research in Motion and software firms such as Open Text and Descartes Systems. In the latter case, the McMaster University Medical Centre and affiliated teaching hospitals have triggered the emergence of a research-intensive health services cluster.

Third, intangible assets have attained unprecedented levels of importance in the determination of competitive success for firms. As Leadbeater (1999) argues, most of us earn our living by producing intangible rather than physically tangible things. This is not to deny the continuing importance of tangible commodities in our lives, but merely to emphasize that competitive success, even for those producing tangible commodities, depends on the extent to which products can be imbued with desirable intangible assets. Accordingly, knowledge – that is, ideas, know-how, creativity and imagination – has become the most important resource for economic prosperity.

If it is true that the production of intangible assets and products has become central to regional and national economic vitality, one particular subset of these activities has, according to some well-respected analysts, assumed a position of increasing prominence in contemporary market economies – that is, the production of cultural products. Included here are activities as diverse as book and magazine publishing, television, film and video production, live and recorded music performance, multimedia, advertising, design of apparel, footwear, jewelry and furniture, live theatre, museums, and specialty food and beverage production. The common attribute shared by all of these activities is their high degree of cultural content. In other words, their competitive success rests on their originality, distinctiveness, and the creativity and imagination of their producers. As geographer Allen Scott (1997; 2000), planning scholar Sir Peter Hall (1998), social analyst Joel Kotkin (2000) and others have recently argued, cities have long been the pre-eminent centres for the production of such products. As their production increases in importance, so too do the 'cultural economies of cities.'

Each of the characteristics of the learning economy outlined above privileges city-regions as the principal sites of innovation and production of knowledge-intensive goods and services (Glaeser, 1998). Given the interactive and social nature of innovation, city-regions provide the ideal space in which social learning processes can unfold, for the reasons spelled out below.

City-Regions as Spaces for Interaction and Knowledge Circulation

The sheer density and concentration of economic actors in large cities offers multiple opportunities for contact, interaction and information circulation over time. Supporting this interaction is a large concentration of specialized providers of services and goods operating within a well-defined social division of labour in the city (Porter, 2000). Furthermore, while the simple geographical concentration of economic actors facilitates productive interaction, spatial concentration in larger urban regions provides another ingredient that is essential to the innovation process.

In many sectors of the economy, innovation depends on the sharing of both explicit or codified knowledge as well as tacit knowledge. The latter form of knowledge is not readily transmitted between actors unless they share a common code of communication and shared norms and expectations governing the practices of individual firms (Gertler, 2003). Recent empirical work on the geography of innovation confirms that these commonalities are most likely to arise when the parties concerned are located in the same region. Regional institutions play a key role in producing and reproducing these shared codes and norms (or what we might think of as the essence of a unique ‘regional culture’), whether in California’s Silicon Valley, in the fabled industrial districts of Europe and Asia, or in Canada’s own centres of knowledge-intensive production (Saxenian, 1994; Cooke and Morgan, 1998; Wolfe and Holbrook, 2000). Moreover, these commonly shared codes of communication and norms of behaviour constitute an important, regionally-specific intangible asset which helps build and maintain collaborative, social learning relationships by reducing uncertainty, building trust, and enhancing the sharing of tacit knowledge between local economic actors. This set of arguments is also captured by the increasingly familiar term ‘social capital’ (Putnam, 1993) which conveys the same idea of intangible assets that support productive social interaction. City-regions can be regarded as places where social capital between economic actors is readily generated. As a result, they have become places where socially organized learning processes take root and flourish – what some have called ‘learning regions’ (Florida, 1995; Morgan, 1997; OECD, 2000).

City-Regions as Talent Generators, Attractors and Retainers

Another distinctly urban advantage of large city-regions is their ability to produce, attract and retain those workers who play the lead role in knowledge-intensive production and innovation – those who provide the ideas, know-how, creativity and imagination alluded to above. Because production in many growing sectors of the economy is increasingly oriented to non-tangible assets, the locational constraints of earlier eras – for example, the access to good natural harbours or proximity to raw materials and cheap land and energy sources – no longer exert the same pull.

Instead, what matters most now are those attributes and characteristics of particular places that make them attractive to potentially mobile talent. The most recent research on this question

indicates unequivocally that the generation, attraction and retention of potentially footloose talent – the most crucial resource in the knowledge-based or learning economy – depends much more on considerations such as: the richness of cultural amenities, recreational opportunities, and the ‘buzz’ of the local arts and music scene, the attractiveness and condition of the natural environment and built form, the quality of public schools, and safety from crime (Florida, 2000; Glaeser, 2000; Glaeser et al., 2001).

Local diversity is also extremely important, in at least two senses: first, the diversity of labour market opportunities for subsequent career advancement (and related to this, the potential that one’s partner will also be able to find appropriate work in the same local labour market); and second, the openness of local economic and social systems to diverse, talented newcomers. Indeed, measures of local openness, tolerance and social diversity appear to dominate all other considerations in recent analytical studies of the geography of growth in knowledge-intensive, creativity-intensive activity in US metropolitan areas (Florida, 2002).

In a recent application of this analysis to city-regions in Ontario and the rest of Canada, Gertler, Florida, Gates and Vinodrai (2002) conclude that the key urban attributes of creativity and diversity/openness exert an even stronger pull on talented labour than was found in the United States. When evaluated against other North American city-regions in the same size cohort, Ontario city-regions such as Toronto, Ottawa, Kitchener-Waterloo, London and (to some extent) Hamilton compared quite favourably (Table 1).

These results suggest that, increasingly, the urban character of Ontario’s major city-regions has become our pre-eminent competitive asset in retaining, attracting, and growing dynamic, high-value-added employment and investment. As we shall argue below, it is for this reason that there is a direct connection between the way that urban regions are governed and provincial economic competitiveness. Taken together, these processes and dynamics explain why, despite the advent of globally-organized economic activity and the increasingly widespread use of the internet and other forms of information and communications technologies (ICTs), innovation, knowledge-intensive production and other forms of creative activity have become *more*, not less, geographically concentrated, and concentrated above all in larger city-regions. Much of the long anticipated decentralization of economic activity resulting from the widespread use of ICTs has failed to materialize, for good reason. Instead, cities’ advantages in supporting knowledge-based growth have come to be summed up in a single word: ‘buzz’ (Leamer and Storper, 2001; Morgan, 2001; Storper and Venables, 2002; *The Economist*, 2002; Gertler, 2003). In short, larger city-regions have become the key nodes in the production and flow of ideas – that is, learning.

The impact of governance structure on a region’s economic performance is especially important for Ontario’s cities. Successful economic development ultimately rests on a region’s ability to attract and retain two key inputs: skilled labour and capital. The analysis above suggests that, increasingly, investment capital will flow to those places that are successful in attracting and retaining talented labour. So what are the factors that anchor such workers in particular places?

TABLE 1: ONTARIO’S CITY-REGIONS – NORTH AMERICAN RANKS BY POPULATION SIZE

City-Region	Talent ¹ Index	Bohemian ² Index	Mosaic ³ Index	Tech-Pole ⁴ Index
<i>Population > 1 million (rank amongst 43 city-regions)</i>				
Toronto	24	4	1	15
Ottawa	10	14	9	23
<i>Population 500,000 - 1 million (rank amongst 39 city-regions)</i>				
Hamilton	35	18	2	37
<i>Population 250,000 - 500,000 (rank amongst 68 city-regions)</i>				
Kitchener	46	15	3	15
London	28	18	6	26
Oshawa	67	36	11	54
St. Catharines-Niagara	66	27	8	58
Windsor	52	49	5	63
<i>Population < 250,000 (rank amongst 159 city-regions)</i>				
Sudbury	142	128	16	120
Thunder Bay	125	103	6	76

¹ Percent of population 18 years and older with a university degree

² Concentration of employment in creative/artistic occupations

³ Percent of population born outside Canada

⁴ Concentration of employment in technology-intensive manufacturing and service sectors

Source: Gertler et al. (2002)

The work of Florida and colleagues reviewed above suggests that for US city-regions such as Boston or San Francisco, world-class institutions of research and higher learning are one of the key attractors. These institutions act to attract both the talented people who wish to study or work there, as well as the firms who want to employ their graduates (and possibly, their faculty). The net result is the local accumulation of a critical mass of employment opportunities in firms or public sector organizations in which cutting-edge work is being done – another crucial attractor variable. Of course, this process works considerably better when the region also provides a strong quality of life, and both Boston and San Francisco offer an appealing physical setting and built environment.

In the case of Ontario's city-regions, quality of life is an especially critical variable. Salaries for talented workers (in Canadian dollars) cannot compete head-to-head with US salaries. Research budgets for star faculty at Ontario's universities have improved in recent years thanks to both federal and provincial initiatives, but still lag behind the level of resources available at the best American universities (public and private). In such a competitive environment, quality of place emerges as an even more crucial source of local competitive advantage than it is in the US (as the comparative US-Canada analysis above confirms).

The institutions of urban governance – including municipal government at the local and regional scale, and provincially determined statutes and regulations pertaining to land use, finance, and infrastructure – largely shape the physical and social character of our city-regions. In doing so, they also determine the extent to which such places are able to attract and retain highly educated workers. A strong regional structure for governance has been shown to play a very important role in this process. In the most successful US city-regions, the mix of public and private elements in this governance structure is typically tilted more strongly in the direction of private mechanisms for governance (such as private-sector umbrella organizations for the governance and promotion of regional prosperity), along with a multiplicity of special-purpose public or quasi-public authorities for delivering particular services at a regional scale. Even functions such as regional planning may be carried out in this fashion (as the examples of New York's famous Regional Plan Association or the more recent formation of Joint Venture: Silicon Valley indicate). In contrast, the tradition in Canada and Ontario has favoured a stronger role for public sector authorities at the regional scale (see section 4.3 for a more detailed discussion of the different models employed). The point is that in both the United States and Canada, some level of co-ordination at the regional scale is widely viewed as essential to achieving and maintaining the quality of place that is so important in today's competitive world.

1.2 The Contribution of Ontario's City-Regions to the Ontario Economy

The preceding section has reviewed the most important conceptual arguments arising from the international literature on the role of cities in the knowledge economy. In this section, we consider the extent to which Ontario's city-regions have performed as leading centers of wealth generation and economic dynamism. We provide a brief overview of some recent quantitative evidence documenting the contribution of Ontario's city-regions to the performance of the provincial economy. Much of the evidence presented below is based on analysis of the seven largest census metropolitan areas (CMAs) in Ontario (Toronto, Ottawa-Gatineau, Hamilton, Kitchener, London, St. Catharines-Niagara, and Windsor). Where available, data will also be presented for Ontario's other CMAs (Kingston, Sudbury, and Thunder Bay).²

² Unless otherwise specified, the data presented in this section were supplied by the Urban Economic Development Branch of the Ministry of Enterprise, Opportunity and Innovation, based on data from Statistics Canada and the Conference Board of Canada. Figures for the

Employment and Output Generation

Traditionally, employment and output are two key indicators of local and national economic health. How important are Ontario's city-regions in generating jobs and output? In 2001, the seven largest CMAs in Ontario accounted for 69.9 percent of all population and 71.8 percent of all employment in the province. Between 1991 and 2001, these same metropolitan regions were responsible for producing 82.4 percent of Ontario's employment growth and 81.4 percent of its population growth.

The top seven CMAs also generated 72.6 percent of Ontario's real GDP and 72.8 percent of the province's personal income in 2001 (see Table 2). The Toronto region alone accounted for just over 47 percent of Ontario's GDP.

In 2001, the seven largest CMAs in Ontario accounted for 26.5 percent of the population of Canada and 28.4 percent of employment. The top seven CMAs in Ontario generated 30.5 percent of Canada's GDP and 30.0 percent of personal income.

TABLE 2: SUMMARY OF ONTARIO CITY-REGIONS' CONTRIBUTION TO THE ECONOMY OF ONTARIO AND CANADA

In 2001, Ontario's 7 largest city-regions ³ accounted for:
€ 69.6% of Ontario's population; 26.5% of Canada's population
€ 71.8% on Ontario's employment; 28.4% of Canada's employment
€ 72.6% of Ontario's real GDP; 30.5% of Canada's real GDP
€ 72.8% of Ontario's personal income; 30% of Canada's personal income
€ 82.4% of Ontario's employment growth; 35.1% of Canada's employment growth, 1991-2001
€ 81.4% of Ontario's population growth; 39.8 percent of Canada's employment growth, 1991-2001

Source: Urban Economic Development Branch of the Ministry of Enterprise, Opportunity and Innovation; Statistics Canada, 1991 and 2001 Census and CANSIM.

Toronto region include the City of Toronto plus Halton, Peel, York and Durham regions and the Oshawa CMA.

³ Toronto/Oshawa, Ottawa-Gatineau, Hamilton, Kitchener, London, St. Catharines-Niagara, and Windsor CMAs

Business Start-Ups

A key indicator of economic vitality is the rate at which new firms are being created. One way to approach this is by studying the prevalence of small businesses in particular communities. A recent report published by the Bank of Montreal aims to identify Canada's 'hotbeds' of small business activity (BMO, 2003). Ontario's seven largest metropolitan areas together accounted for 211,700 small businesses (with between 1 and 49 employees) in 2002, representing some 82.2 percent of Ontario's total.⁴ The Toronto CMA alone was home to 129,400 of these businesses. Looking at the growth in numbers of small businesses between 1998 and 2002, Oshawa ranked number three in Canada at 8.9 percent (see Table 3), while Ottawa-Hull was fourth at 7.5 percent. Kitchener, Toronto and Hamilton ranked fifth through seventh respectively.

In terms of total numbers of establishments (of any size), eight of the largest CMAs in Ontario (including Kingston) accounted for 70.5 percent of the total number of establishments in Ontario in 2001. The Toronto CMA was home to 43.2 percent of the provincial total.

TABLE 3: SMALL BUSINESS (1-49 EMPLOYEES) AND RANKS BY GROWTH RATE FOR ONTARIO CMAs

Census Metropolitan Areas	Prov.	Payroll enterprises (thousands) 2002	Change in payroll enterprises 1998-2002	Rank in Canada	Change in CMA population 1998-2002	Rank in Canada
Oshawa	ON	4.7	8.9%	3	7.0%	2
Ottawa-Hull	ON/QC	25.4	7.5%	4	4.5%	8
Kitchener	ON	10.4	6.8%	5	5.6%	6
Toronto	ON	129.4	6.5%	6	6.7%	3
Hamilton	ON	15.1	4.2%	7	4.2%	9
Windsor	ON	7.1	1.4%	13	5.1%	7
London	ON	10.2	1.2%	14	2.7%	11
St.Catharines-Niagara	ON	9.4	1.2%	15	0.9%	17
Thunder Bay	ON	3.3	-1.2%	18	-2.6%	24
Sudbury	ON	3.6	-6.6%	24	-4.3%	25

Source: BMO (2003), Exhibits 2 and 6.

⁴ This figure includes the Oshawa CMA as part of the Toronto region, to be consistent with the 'top seven' figures provided above. Some of these are new businesses, but not necessarily all of them.

Human Capital and Productivity

Given the importance of highly educated and trained workers in today's economy, measures of human capital are of obvious significance. In 2001, the eight largest CMAs in Ontario accounted for 85 percent of those in Ontario (ages 25 to 64) with a university degree and 70 percent of those with a college diploma or certificate.

This advantage in terms of the stock of highly educated human capital should be expected to enhance the productivity of workers located in larger city-regions. In its first annual report, the Ontario Task Force on Competitiveness, Productivity and Economic Progress (2002) mapped the productivity of the 16 North American states and provinces with populations over 6 million against the percentage of their populations living in metropolitan areas greater than 100,000. The results show a strong positive relationship between degree of urbanization and productivity.

Baker and Treffer (2002) sought to analyze the relationship between degree of urbanization and productivity more closely. Using the 1998 U.S. Current Population Survey and the 1998 Canadian Survey of Consumer Finances, they analyzed whether or not the returns to an advanced degree (master's degree or higher) are greater for those workers who choose to locate in urban regions.

Baker and Treffer hypothesized that if urban environments do indeed add value to personal investments in education, then the returns to education should be higher in metropolitan regions than in rural settings. To this end, they calculated the difference between city-dweller and non-city-dweller earnings for various levels of education. If an urban-region location has no impact on productivity, average earnings for city dwellers with an advanced degree should not differ appreciably from those of non-city dwellers.

With regard to returns to education, the authors found the most marked differences among holders of advanced university degrees and high school dropouts. Those with advanced degrees receive a much bigger return to their education if they live in cities: they earn 10.4 percent more than those in non-urban locations. On the other hand, high school dropouts earn considerably more (8.8 percent) if they locate *outside* of cities. On the basis of these findings, Baker and Treffer conclude that there is an important positive connection between urbanization and returns to education.

It seems clear from the preceding analysis that Ontario's city-regions are crucially important generators of employment, wealth, economic dynamism and productivity growth. They are Ontario's prime economic assets and, as such, it is vital that they be governed and managed in a way that enhances (rather than hinders) their economic potential. At a time when competition between national and sub-national jurisdictions is becoming increasingly intense, the governance of Ontario's city-regions needs to be carefully examined to ensure that it adequately supports their wealth-generating capability. Given the strong connection between urban character and

economic success described in section 1.1, this underscores the overriding importance of governance structure for ensuring the future prosperity of Ontario.

2 CHALLENGES FACING ONTARIO CITIES AND CITY-REGIONS

Notwithstanding the major contributions that Ontario's city-regions currently make towards sustaining the province's economic vitality, it is important to acknowledge that these regions are also the living spaces for most Ontarians. The quality of that space, and the public services on which we depend, are important elements in defining the quality of life in the province. These cities are also currently experiencing unprecedented levels of stress from a variety of sources.

Before we consider the current relationships between the Province and its cities, as well as the relative merits of various alternatives to the status quo, it is useful to have a clear sense of the most significant challenges currently facing Ontario's cities and city-regions. The following review focuses on the challenges confronting the province's largest urban regions, as well as mid-size urban regions in Southern Ontario. We address the principal challenges facing Ontario's smaller and more remote urban centres in a companion paper on "Communities at Risk."

2.1 Economic Challenges

The biggest economic challenges facing Ontario's cities and city-regions can be summed up under the following themes: the transition to a continental scale of economic organization; the transition to a knowledge economy; and attracting, retaining, and enabling highly skilled labour.

In the decade and a half since the signing of the US-Canada Free Trade Agreement, the organizational structure of the Ontario economy has undergone a major transition from a national (east-west) to a continental (north-south) orientation. This shift translates into four distinct realities. First, markets have become integrated, so that a growing number and proportion of the goods and services produced in Ontario are exported to the United States. For many sectors of the Ontario economy, the US market has become increasingly dominant. Second, the scale of competition has also undergone a shift to the continental level. While American firms have long constituted a primary source of competition for Ontario firms, this has intensified in recent years. Third, Ontario's city-regions have also come to experience heightened competition for investment capital, as they are forced to compete ever more aggressively with their counterparts in the United States. Finally, large, multi-locational firms have restructured their operations away from a national logic to a continental one. This means that headquarter functions have undergone increasing centralization in a single location, along with attendant activities such as research and development. For Ontario's largest communities,

this poses a very significant challenge.⁵ In order for them to remain attractive sites for activity, they must offer a set of distinctive local advantages, at costs that are competitive (see Fiscal Challenges below).

Second, as noted in section 1, knowledge, learning, innovativeness and creativity have become increasingly important sources of economic wealth in the contemporary economy. This presents the Province and its city-regions with a dual challenge. First, there is a pressing need to facilitate the transition to more knowledge- and innovation-intensive forms of production within the existing portfolio of traditional economic activities. Second, there is an equally compelling challenge to facilitate and support the emergence of firms in the new knowledge-intensive sectors that have the greatest long-term potential to generate wealth. As noted earlier, the localized nature of knowledge flows suggests that city-regions have an important role to play in enabling this process, but the provincial government is also deeply implicated, for reasons spelled out in the following sections of this paper.

Finally, as highly talented – and potentially footloose – labour has become the most important resource in the knowledge economy, the attributes that shape quality of place in our city-regions have become critical determinants of competitive success. Those characteristics of cities that create the attractive pull to embed this mobile resource include openness and tolerance of diversity, a dense, richly mixed collection of cultural amenities and creative activities, diverse, healthy and distinctively authentic neighbourhoods within the urban fabric, and high-quality public services (especially schools and health care). At the same time, given the global battle for talent, the government of Ontario and the province's city-regions also have to find better ways to support the integration of talented newcomers from abroad into local labour markets in order to enable them to realize their full economic potential.

2.2 Social Challenges

The social challenges facing Ontario's cities and regions derive from processes of change that affect all of society and are closely related to the economic challenges outlined above. Their impacts are also typically most evident in the larger urban areas. Those processes include the demographic transition, an aging society, changes in life styles and living arrangements, increasing social and ethnic diversity, and more intense concentrations of poverty and special needs groups. All of these changes have their own internal dynamic, their own spatial pattern, and their particular set of implications for public policy and governance.

The principal challenge for cities in the province is adapting to the rapidity of social change and increasing diversity, and the uneven pattern of growth and decline. The demographic transition, as David Foot points out in his report to the Panel, has altered the demands for almost all kinds

⁵ For recent evidence of the negative impact of this trend on the Toronto region's level of headquarter activity, see Gertler et al. (2000).

of goods and services, both private and public. Since the fertility level is now well below the replacement rate, the only means by which a community or urban area can grow is through immigration, either from other parts of the province or country, or from abroad. Those areas, as argued in the previous section, that do not have the attributes, and the overall quality of life, that attract migrants will likely face population decline in the future. Within cities, a process of demographic thinning, following from smaller household size and an aging population, will reduce the populations of many older neighbourhoods.

A declining population does not necessarily mean a deterioration in the quality of life or public services, or increased poverty, but it does pose difficulties. Population decline, whether of small cities or older neighbourhoods, has to be carefully managed to avoid serious consequences for those who remain.

An aging society also shifts the balance of services that a resident population requires. Older populations, by definition, make more use of medical and health services and less use of the school system than younger populations. The impacts of an aging population are also unevenly distributed across the province and among urban areas. Those areas with the most rapidly aging populations are also the communities that are growing most slowly and that have the highest demands for services and the weakest tax base.

High rates of immigration introduce a further set of challenges. First, immigration is now the largest component of population growth, as well as labour force growth, in the province. The contribution of immigration to the growth and skill level of the labour force is also likely to increase. Second, the dominant sources of immigrants over the last two decades have shifted to non-traditional countries in Asia, Africa and Latin America. For the most part these migrants qualify as visible minorities, often with distinctive language and cultural backgrounds. We do not know whether such groups will behave differently in the marketplace, or in the forum of social democracy, but they will need to be included more fully in civil society and in the political process than they have to date.

Third, immigration flows tend to be highly concentrated geographically, and are especially focussed on municipalities in the greater Toronto region. Over 80 percent of immigrants to the province settle in only five urban areas. The result has been a continued concentration of growth in metropolitan areas and an unprecedented transformation of the social landscapes of those communities receiving immigrants. The rest of the province, in contrast, remains relatively homogeneous in social terms. As a consequence, it will be increasingly difficult to achieve a consensus on social policies and priorities when the province's communities differ so widely in terms of both growth prospects and social and ethnic characteristics. At the same time, the needs of local communities for particular social services and educational programs will be increasingly uneven geographically.

The challenges posed by these trends are magnified when and where disadvantaged members of the above populations are concentrated in specific neighbourhoods and communities. The most

obvious example is in communities where there is an intersection of low income, recent immigrants who also have poor language or workplace skills, and fragmented family or household structures.

To summarize, the Province will have to find suitable ways and means to deal with a host of new challenges in the arena of population growth and social change. One challenge will be to mitigate the impacts of further metropolitan concentration and to address the issue of downsizing communities that face population and employment decline. Policies to upgrade the quality of life and service levels in our cities⁶ to attract highly mobile populations and new investments will have to be designed in ways that do not augment the rapid growth of the larger metropolitan areas at the expense of continuing decline in the viability of smaller communities.

A second challenge will be to respond to an aging population and the highly uneven demands that this population will place on the public service network. As the level of specialization in public services that people want and expect increases, the tendency will be for those services to concentrate still further in the larger metropolitan areas. Unfortunately, the demand for such services will be higher precisely in those small communities that can least afford them.

Third is the diversity challenge. Our collective ability to respond to the transformation in social and ethnic characteristics in those communities receiving the bulk of new immigrant flows requires that we first acknowledge the need to incorporate diversity in all aspects of public and community life. The response by governments has to be both sensitive and imaginative, not least because of the increasing contrast between areas of exceptionally high diversity and those of enduring social homogeneity.

2.3 Fiscal Challenges

The major fiscal challenge facing large cities and city-regions was identified as part of the discussion of economic and social challenges above. The challenge is for cities and city-regions to provide a wide range of local services with the fiscal resources available to them. On the economic front, this means that they have to provide the services needed to be competitive and to attract business and skilled labour. These services include transportation and communications infrastructure as well as services that enhance the quality of life: parks, recreational, and cultural facilities, social services, a high quality school system, police protection, health care, air and water quality. With respect to the social challenges, as noted above, large city-regions attract a disproportionate share of low-income individuals and households who seek employment opportunities and who are able to take advantage of a wider range of more specialized social services than are usually available in smaller municipalities. Many of these services are delivered at the local level. Large cities also attract a very high proportion of the nation's new

⁶ These include, for example, investment in education, health care, cultural programs and facilities as well as policies that enhance the diversity and mix of land uses.

Canadians and, while the long-run benefits of this inflow of immigrants are obvious, the short-run costs to local governments of settlement and social integration can be significant.

Not only do large cities and city-regions make expenditures on a wider range of services than do smaller cities and urban areas, expenditures per capita are generally higher in large cities and city-regions.⁷ For example, large cities spend more on transportation because they are more likely to have an integrated transit system with subways, light rail lines, and an extensive bus network. Urban densities are not sufficient in smaller cities to make public transit economically viable. The higher concentration of poverty in large cities necessitates greater expenditures on social services; the higher concentration of people means more specialized police services; higher densities means more specialized training and equipment for fire fighters. Cultural facilities (such as opera houses or art galleries) are only economically viable in large cities because they require a minimum size to make provision possible. Moreover, people from outside large cities make use of cultural facilities as well as social and medical services but do not directly contribute to the support of those facilities.

The increasing cost of infrastructure has also put increased fiscal pressure on large cities and city-regions. These costs are especially high in those cities that are experiencing urban sprawl.⁸ Fragmented governments in metropolitan areas encourage scattered, leap-frog development that may be more costly to serve. Low densities of urban development are not only more expensive than more compact forms of development, but also undermine those aspects of quality of place discussed above that flow from higher densities and mixed land uses.

Municipalities in Ontario are also facing fiscal challenges as a result of government policies. First, the off-loading of services by both the federal and the provincial governments (particularly the increased municipal funding responsibility for social services) has increased financial pressure on municipalities (see section 3.2). This pressure will increase further in the event of an economic downturn and increased demands for welfare assistance. Second, the policy of municipal restructuring (see section 3.4) has increased financial pressures on municipalities rather than producing the overall cost savings that were officially projected (Slack, 2000). Although there have been some savings from staff reductions, the harmonization of wages and service levels has on the whole resulted in higher costs for newly amalgamated cities, which will

⁷ At the same time, there may be opportunities for lower expenditures per capita for services in large cities to the extent that the local government can take advantage of economies of scale in service provision. Economies of scale (discussed further below) occur where the per unit cost of producing particular service falls as the quantity of the service provided increases.

⁸ For example, the GTA Task Force (1996, pp. 111-112) estimated that, if development patterns continue in the Toronto area as they have over the past 25 years, the GTA will require about \$55 billion of capital investment over the next quarter-century to build new road, water, and sewer networks, as well as another \$14 billion in operating expenditures. A more compact and efficient development pattern could save an estimated \$12.2 billion in capital costs over the next 25 years or roughly 22 percent of the \$55 billion.

continue to be felt in the future.⁹

At the same time that municipalities are facing increased expenditure pressures, there has been no diversification of municipal revenue sources. Municipalities continue to rely mainly on property taxes and user fees to finance services. Not only are property taxes not a particularly appropriate source of finance for ‘soft’ services (such as social expenditures) which should, in principle, be paid from taxes that are more closely related to ability to pay, but they are also a strikingly inelastic source of revenue – that is, they do not increase directly with growth in the economy as do income and sales taxes. Although Ontario cities rely heavily on the property tax, cities in other OECD countries have access to income, general sales, and selective sales taxes (Kitchen, 2002b).

In Ontario, as elsewhere in Canada, provincial legislation prohibits municipalities from incurring a deficit in their operating budgets. Operating expenditures are simply not allowed to exceed operating revenues. They are also constrained by the Province in terms of how much debt they can incur to meet capital requirements. At one level, this high degree of provincial control means that there simply cannot be any “fiscal crisis” at the local level. The only way to achieve this balance between revenues and expenditures, however, is by reducing expenditures or by raising property taxes. Neither prospect bodes well for meeting the economic and social challenges facing large cities and city-regions.

3 CURRENT RELATIONSHIPS BETWEEN THE PROVINCE AND MAJOR CITIES AND CITY-REGIONS

Under the Canadian constitution, powers are divided between the federal and provincial governments. The provinces have exclusive powers over social services, health, and education but may also be involved in the funding of provincial police forces, roads, transit, water and sewers, recreation and culture, housing, and other services. Municipalities have no original powers in the constitution; they are only mentioned to the extent that they are creatures of the province. Under section 92(8) of the Constitution Act, municipal institutions are placed under the purview and responsibility of the provinces. This means that provincial governments have control over the very existence of local governments and their geographic boundaries, the expenditure responsibilities of municipalities, the standards for local service provision, the revenues they can raise, the structure of the property tax, the extent of local borrowing, and planning decisions.

⁹ Kitchen (2002a, p. 314) disagrees that restructuring always increases the overall cost of running municipal governments. In the Ontario context, it is difficult to separate out the impact of municipal restructuring from the impact of local services realignment and property tax reform which were introduced at the same time.

The relationship between the Province and major cities and city-regions is set out in the Municipal Act. Other examples of the relationship can be found in recent provincial initiatives that affect local government in Ontario -- Local Services Realignment (LSR), provincial grants, municipal restructuring, and property tax reform. This section reviews recent changes to the Municipal Act and describes these other initiatives.

3.1 The Municipal Act

The provincial legislation that governs municipal powers in Ontario is the Municipal Act. A new Municipal Act came into effect on January 1, 2003. Under this legislation, the stated purpose of municipalities is to provide services and other things that the municipality considers necessary or desirable for its residents; manage and preserve the public assets of the municipality; foster the current and future economic, social and environmental well-being of the municipality; and deliver and participate in provincial programs and initiatives.

Part II of the Municipal Act sets out the powers of municipalities through new natural person powers and spheres of jurisdiction. Natural person powers are essentially the powers of a business corporation. This means that municipalities may enter into contracts, purchase, own and dispose of property, hire, compensate and dismiss employees, delegate responsibilities, provide and charge for goods and services, and dispose of assets (Mascarin and Williams, 2002, p. 12).

The spheres of jurisdiction in which municipalities can pass by-laws are set out for single-tier municipalities in S. 11(1). They include: highways (including parking and traffic on highways), transportation systems (other than highways), waste management, public utilities, culture, parks, recreation and heritage, drainage and flood control (except storm sewers), structures (including fences and signs), parking (except on highways), animals, and economic development services.

Although it is less prescriptive than the previous legislation and does provide municipalities with more autonomy and flexibility, there is still considerable provincial control over what municipalities can and cannot do (Mascarin and Williams, 2002, p. 40). Furthermore, many of the new powers will be subject to provincial regulations that have not yet been released but are likely to mean more provincial requirements that have to be met by municipalities. Some authors have concluded that the new Municipal Act in Ontario reflects “the inherent and inescapable tension between the attempt to achieve municipal autonomy on the one hand and the endeavour to maintain provincial control on the other” (Mascarin and Williams, 2002, p. 1).

Unlike most other provinces in Canada, larger urban municipalities in Ontario do not have separate charters that exempt them from the general applicability of the Municipal Act (Mascarin and Williams, 2002, p. 3). As will be discussed further below, there are a number of areas in which large cities and city-regions are different from other municipalities and thus may require different powers.

Some authors have argued that the status of Canadian cities overall is changing, however, as a result of a court case in Hudson, Quebec. When the town banned the use of pesticides, a chemical company launched a legal challenge. The courts ruled that cities are competent to pass regulations to protect their residents' health, as long as they do not contravene provincial laws. Stein (2003) and others have argued that this legal precedent has served to expand municipal powers.

3.2 Local Services Realignment

The Province appointed the Who Does What Panel in 1996 to make recommendations on which services should be provided by the Province and which services should be provided by local governments. The rationale for this exercise was to promote more efficient and accountable local government. The Panel set out four principles to guide the division of responsibilities between the Province and local governments:

1. Municipal government, in keeping with its historic function, should have a strong role in 'hard services,' such as services to property and community infrastructure. The Province should have a strong role in the provision of 'soft services,' such as health, welfare and education.
2. Government programs aimed at income redistribution should be funded by the Province.
3. Where possible, only one level of government should be responsible for spending decisions, and the level of government making the spending decisions should have responsibility for the funding of that service.
4. There should be an appropriate balance between the allocation of responsibility and the financial resources available to support those responsibilities.

Following the release of the recommendations of the Who Does What Panel, the Province undertook a major local services realignment (LSR) in 1998. Table 4 shows the changes that occurred in that year throughout the province. In each municipality, some services were uploaded to the Province and some were downloaded to municipalities. Municipalities were given full responsibility for funding transit, police, water and sewers, property assessment, social housing, and the farm tax rebate. Some funding responsibility for Family Benefits was downloaded to municipalities along with the associated administrative costs. Other social assistance remained cost-shared between the Province and municipalities even though the Who Does What Panel recommended that these responsibilities be fully funded by the Province. The Province provided tax room to municipalities by taking over the residential property tax for education and reducing the tax rate.

3.3 Provincial Grants to Municipalities

Prior to 1998, the Province gave a wide range of conditional transfers to municipalities. Under conditional grant programs, the Province determined eligibility, conditions, and procedures that had to be followed for the municipality to receive the grant. Although there are several justifications for conditional grants to municipalities (see Bird and Slack, 1993), there are some disadvantages associated with this source of revenue. When the level of government making the spending decisions (municipalities) is not the same as that raising the money (the provincial government), accountability is blurred. Moreover, grants are often not reliable because donor priorities change over time and grants tend to reflect the priorities of the donor government which may not correspond to those of cities. Most of these grants were eliminated as part of the LSR in 1998.

The main provincial grant to municipalities in Ontario since 1998 is the Community Reinvestment Fund (CRF). It was introduced to ensure that the local services realignment was revenue neutral in each municipality. The formula has not changed much since 1998, however.

3.4 Municipal Restructuring

As noted above, the provincial government has the power to create and destroy municipalities. Municipal restructuring has been an ongoing process in Ontario for over 30 years. During the late 1960s and early 1970s, two-tier regional governments were created to replace county governments in the growth areas of the province. Responsibility for the delivery of a number of lower-tier services, such as water, sewers, and regional planning was shifted to the upper-tier level. From the mid-1970s until 1996, restructurings generally took the form of annexations and locally-initiated amalgamations.

Bill 26, The Savings and Restructuring Act, 1996 was passed to encourage further municipal restructuring to achieve cost savings and to streamline local government. This legislation provided a process to allow municipal restructuring to occur in a timely fashion. Municipalities could restructure if they reached local agreement, provided that the change had the support of the majority of municipalities containing a majority of the population and the support of the majority of members of the upper tier council (where applicable). If local agreement could not be reached, one or more municipalities could request the minister to appoint a commission with full authority to determine the new structure for the municipal area. This legislation, coupled with provincial statements about reducing the number of municipalities in Ontario, put pressure on municipalities to amalgamate (Tindal and Tindal, 2000, p. 108).

The elimination of more than 300 municipalities in Ontario over the period from 1996 to 2001 was a result of both voluntary amalgamations and provincially-imposed amalgamations. Some examples of voluntary amalgamations include Brant County (where six lower-tier municipalities merged voluntarily, with the City of Brantford remaining a separated city) and Prince Edward

TABLE 4: CHANGES IN RESPONSIBILITIES BETWEEN PROVINCIAL AND MUNICIPAL GOVERNMENTS

Responsibility	1997	1998 and beyond
General Welfare Assistance: Benefits Administration	80% provincial; 20% municipal 50% provincial; 50% municipal	80% provincial; 20% municipal 50% provincial; 50% municipal
Family Benefits Assistance: Benefits Administration	Provincial Provincial	80% provincial; 20% municipal 50% provincial; 50% municipal
Child Care Services	80% provincial; 20% municipal	80% provincial; 20% municipal
Long Term Care	Provincial	Provincial
Hostels	80% provincial; 20% municipal	80% provincial; 20% municipal
Homes for Special Care	Provincial	Provincial
Women's Shelters	95% provincial; 5% municipal	Provincial
Social Housing	Provincial-municipal	Municipal
Child Welfare	80% provincial; 20% municipal	Provincial
Municipal Transit	33% provincial; 67% municipal	Municipal
GO Transit*	Provincial	Municipal
Ferries	Provincial	Municipal
Airports	40% provincial; 60% municipal	Municipal
Sewer and water	10% provincial; 90% municipal	Municipal
Policing	10% provincial; 90% municipal	Municipal
Farm Tax Rebate	Provincial	Municipal
Property Assessment	Provincial	Municipal
Libraries	5% provincial; 95% municipal	5% provincial; 95% municipal
Public Health**	70% provincial; 30% municipal	50% provincial; 50% municipal
Ambulances	90% provincial; 10% municipal	50% provincial; 50% municipal
Roads***	Provincial-municipal	More municipal
Gross Receipts Tax	Municipal	Provincial
Provincial Offences	Provincial	Municipal
Residential Education Taxes	School boards	50% prov'l for education; 50% municipal

* The Province took back funding for GO Transit in 2002; development costs still remain with municipalities.

**Changes were made to the downloading of public health and ambulances in 1999.

*** Provincial roads grants to municipalities were cut back in 1996; maintenance of some provincial highways was also transferred to municipalities.

County (where ten lower-tier municipalities and the county government merged into one single-tier government). Examples of provincially-imposed amalgamations include Toronto, Hamilton, Ottawa, Sudbury, Haldimand, Norfolk, and Kawartha Lakes (formerly Victoria County). In some cases, the Province imposed the amalgamation directly (Toronto); in others it appointed a Commissioner whose recommendations were implemented directly (Kawartha Lakes); and in still others, the Province appointed a special advisor whose recommendations were mostly implemented (Ottawa, Hamilton, Sudbury, Haldimand, Norfolk).

3.5 Property Tax Reform

Another example of the changing relationship between the Province and municipalities in Ontario is the reform of the property tax that commenced in 1998 and is still ongoing. Starting in 1998, a uniform assessment system based on ‘current value’ (similar to market value) was implemented province-wide. Because the change in the assessment system by itself would have resulted in large shifts in tax burdens within and between classes of property, a series of tax policy changes were introduced along with assessment reform. Indeed, the provincial government introduced seven pieces of legislation in all.

The reform has meant that the assessment function was downloaded to a corporation comprising mostly municipal officials – the Municipal Property Assessment Corporation (MPAC). The tax-setting process, however, is controlled to a large extent by the provincial government. For example, the Province established ranges of fairness for the relationship between the different tax classes (multi-residential, commercial, industrial, etc.) relative to the residential tax. If ‘tax ratios’ are not within the specified ranges of fairness in a municipality, then that municipality cannot increase the differential between that class and the residential class. For those municipalities, such as Toronto, where the ratio of non-residential property taxes to residential taxes is greater than the provincial threshold, any budgetary increases have to be levied on the residential class. Although municipalities have control over the level of taxes, their control over the distribution of taxes among classes of property has been severely constrained by the Province (Slack, 2002, 583).

4 THE APPROPRIATE LEVEL OF GOVERNMENT AT THE SUB-PROVINCIAL LEVEL

Increasingly, most of the serious challenges faced by cities – economic competitiveness, social polarization, and inadequate fiscal resources (as well as transportation gridlock, loss of agricultural land and environmentally sensitive areas, urban sprawl, air and water pollution that we do not address in this paper) – extend beyond their boundaries into the regions in which they are located. This reality has important implications for the design of government structure at the sub-provincial level: it is essential that there be a region-wide structure to address regional problems. This section reviews a number of different perspectives on the role of government at

the sub-provincial level, sets out criteria for designing government structure, and describes and evaluates different governance models.

4.1 Alternative Perspectives on Local/Regional Government

There are a number of perspectives on the purposes and roles of sub-provincial (hereafter local) governments in a democratic society such as ours. Perhaps the dominant perspective, given the durability and clarity of its basic arguments, derives from mainstream or *neoclassical economic theory*. In this framework, the main purpose of local governments is to maximize individual welfare, and specifically to deliver goods and services to their residents. The optimal or most efficient government, in this framework, is that which delivers a desired level of goods and services at the lowest cost. The specific criteria that are typically used to determine the best or optimal structure are drawn from this perspective and therefore are outlined in more detail in the section below.

Yet, all governments do more than deliver goods and services. They are, in *political theory*, a vehicle for facilitating the democratic process by providing direct access to political representatives and a sharing of political power. They are, in fact, about the distribution of power, about political participation and representation, about seeking a voice in decisions and events that shape everyone's life. They are, in theory, about giving up certain individual rights and obligations and assigning them to a larger collective. That collective, in turn, both reflects and shapes the social nature of the community. The question then becomes one of what is the nature and size of the appropriate collective - that is, the most appropriate design of local structures of governance - and what functions should be assigned to it, in order to achieve the objectives of economic efficiency, democratic representation and a balance of power sharing.

There is also a *territorial argument* that is relevant here. All governments are territorial in the obvious sense that they have a specific location and usually require explicit and non-overlapping spatial boundaries in order to identify their constituents and to define their area of responsibility. The question then becomes how best to divide up a national or provincial territory so that it meets the above objectives. In theory, where and how we define the boundaries for sub-provincial governments also determines what kinds of communities we have. It also influences what baskets of goods and services are appropriate, how political power is distributed, how self-sufficient the unit of government is in terms of fiscal capacity, and who is included in or excluded from that government. There are frequent and well-known examples of where the delineation of municipal governments has been used to embrace desired land uses and populations and to exclude other less desirable uses and people.

Fourth, there is a different but parallel argument that the structure of local governments needs to both mirror and compensate for the tendency for people and production facilities to cluster in space. This process of *spatial clustering* occurs because there are obvious advantages (noted

earlier) for particular groups of people and firms to locate in close proximity.¹⁰ Those advantages include conventional agglomeration economies for firms, as well as the social benefits of being close to individuals of similar attributes or attitudes. This means that local government structures are superimposed on a landscape that is already markedly uneven and characterized by distinct social and economic clusters. In this context, small local governments would tend to be more homogeneous in social terms than the larger governments.

There is a fifth and related line of argument that is embedded in a *social justice framework*. In a democratic and egalitarian society such as ours, there is an implicit social contract that accepts the premise that all citizens of the state have a right to equal access to services, housing and to opportunities for work and the sustenance of a good life. There is also a broad commitment to place-based mobility rights¹¹ in that the commitment applies to all citizens living anywhere in the province or country. Although there are obvious practical constraints, not to mention cost constraints, in meeting this goal in a country the size of Canada (or even a province as large as Ontario), it is nonetheless a principle that is relevant to designing local and regional governments. What is the best vehicle, the optimal level and form of government, for delivery of services under such conditions at a sub-national and sub-provincial level?

4.2 Criteria for Designing Government Structure

Several criteria can be used to design government structure: subsidiarity and local responsiveness, economies of scale, externalities, equity and social justice, and access and accountability.

Subsidiarity principle and local responsiveness

The efficient provision of services requires that decision-making be carried out by the level of government that is closest to the individual citizen. This is known as the ‘subsidiarity principle’¹² and is needed for the efficient allocation of resources, accountability, and responsiveness. As long as there are local differences in tastes and costs, there are clear efficiency gains from delivering services at the local level.

¹⁰ There may also be disadvantages from spatial clustering such as the costs of slower movement and pollution that are associated with congestion.

¹¹ This concept refers to the premise that the rights of Canadians to basic services must include (within limits) the right to receive those services wherever they choose to move.

¹² The subsidiarity principle was included in the Treaty of the European Union in 1992 in the context of the division of powers and responsibilities between European governmental bodies and their member countries. The principle has also been applied to the role and structure of government at all levels (Barnett, 1997, p. 59).

According to the subsidiarity principle, expenditure responsibilities should only be assigned to a higher level of government if it can be demonstrated that it can carry out the function more efficiently than the lower level. With few exceptions (such as national defence and services that involve redistribution), almost all public services should be provided at the local or regional level with local policy-makers making decisions about what services to provide, how much to provide, and who should pay for them. One further consideration here is that, as the quality of services and the level of technical sophistication increase, the ability of small local governments to deliver such services decreases.

Public choice theory argues that small-scale, fragmented local governments have special advantages for local democracy because they maintain a quasi-market. The proliferation of small government units in a metropolitan area results in competition among them. Tiebout, for example, suggested that people "vote with their feet," meaning that they move to the jurisdiction with the tax and expenditure package that reflects what they want (Tiebout, 1956).¹³ This competition benefits citizens through increased efficiency in service delivery or in terms of finding the municipality that has the basket of goods and services that most closely meets their tastes (Boyne, 1992, p. 338). In this framework, a large urban government will be less efficient in meeting the demands of its residents because it will tend to provide a uniform level of public services to people who have different preferences for those services.

Economies of scale

Economies of scale occur where the per unit cost of producing a particular service falls as the quantity of the service provided increases. There are problems with economies of scale as a criterion for designing government structure, however. First, each urban service will likely achieve the lowest per unit cost at a different scale of production. For example, the optimal size of government may be different for fire services than for waste management. These differences mean that it can be extremely difficult to draw boundaries for general-purpose local governments.

Second, the jurisdiction that provides the service is not necessarily the one that consumes it. If consumers are located in adjacent jurisdictions, then the producing jurisdiction could sell output to them. The producing jurisdiction could benefit from economies of scale in production without having to be part of a larger jurisdiction, that is, without requiring the larger population to be located within its own boundaries. A larger government jurisdiction is not necessarily required to achieve economies of scale because the demand and supply of local government services can be separated; economies of scale can be achieved even in a fragmented system. Furthermore, there

¹³ The Tiebout model assumes a large number of small, homogeneous local governments as well as several other assumptions. Criticisms of the Tiebout model suggest that there is a cost to mobility that makes this adjustment less than automatic, that it excludes any discussion of externalities, that it penalizes those who are poor and less mobile, and that it does not consider that people will vote in ways other than with their feet.

is some evidence of higher costs from larger government units because of problems delivering services to remote areas within large jurisdictions or because of “bureaucratic congestion” (Boyne, 1992, p. 336).

Externalities

The provision of some services results in externalities (spillovers) whereby the benefits (or costs) of a specific service in one local government jurisdiction spill over on to residents of another jurisdiction. Examples of services that spill over municipal boundaries are transportation and water. One way to remove the resulting inefficiency is to design government jurisdictions large enough so that all of the benefits from a particular public service are enjoyed within the boundaries of that jurisdiction. Such boundary readjustments would internalize the externalities (those who benefit from the service pay for it). As with economies of scale, however, the optimal sized jurisdiction will be different for different services. Furthermore, the optimal jurisdiction from the point of view of internalizing externalities may conflict with the optimal size required to achieve economies of scale. Other ways to address externalities include provincial grants and coordination among municipalities.

Equity and Social Justice

Equity arguments are at least as important as efficiency arguments in designing government structures. Local government fragmentation means that there are likely to be some rich communities and some poor communities. In these circumstances, the rich communities will have a more adequate tax base with which to provide services and may not have very great demands for services (such as education or social services). The poor communities, on the other hand, may require more services but have only a small tax base on which to levy taxes. The more municipalities there are within a large urban area, the greater will be this problem. One solution is to consolidate the two (or more) areas into one jurisdiction, in effect taxing the rich municipalities and using some of the proceeds to subsidize the poor municipalities. An alternative approach is to shift the redistributive function to a senior level of government or for the senior level of government to provide equalization transfers.

Access and Accountability

This criterion suggests that citizens should have access to local government so that they can influence government policy. This is done through public meetings, hearings, elections, and direct contacts with officials (Bish, 2001, p. 7). Smaller government units can provide the average citizen with greater ‘access’ to local decisions: “As the levels of consolidation and concentration in the local government system rise, so the capacity of the public to monitor policy makers’ behavior falls” (Boyne, 1992, p. 338). Moreover, Bish argues that the larger the local government, the more likely it is that well-organized special interest groups will dominate public hearings and meetings and that individual citizens will participate less (Bish, 2001, p.7).

Accountability is closely related to access: the more accessible politicians are to their constituents, the more easily they can be held accountable for their actions. A more fragmented system of local governments, in theory, should increase public scrutiny and accountability and result in lower service costs, at least for certain kinds of services. Accountability requires a link between expenditure and revenue decisions: the body making the decisions about how much to spend should be responsible for raising a large portion of the revenues it requires: “the costs of local decisions should be fully borne by those who make them” (Bird, 2001, p. 117). If there is no accountability in decision-making, there is no incentive to allocate resources efficiently across the competing services. Local governments must also be accountable to senior levels of government to the extent that they receive transfers from them. On the other hand, a more fragmented system of local government may make it difficult for citizens to know who is responsible for what.

Summary of Criteria for Designing Local Government

The optimal design of local government structures depends on which criteria are to be satisfied. Three criteria (economies of scale, externalities, and equity) lend themselves to large government units over an entire urban area or city-region; other criteria (subsidiarity and local responsiveness and access and accountability) point towards smaller government units. Although there is often a conflict among these criteria, it will be noted below that some arrangements can allow both sets of criteria to be met at the same time.

4.3 Governance Models

This section describes and evaluates four governance models that are used in large urban areas and city-regions: two-tier governments, one-tier governments, voluntary cooperation (including inter-municipal agreements), and special purpose districts. It should be noted at the outset that there is no single model that stands out above the rest. Different structures have worked in different places at different times. The appropriate governing structure in any municipality depends on its specific characteristics – the nature of the services it provides, the revenue sources available to it, the size and location of the municipality, the size and growth rate of the municipality relative to the province as a whole, the nature of intergovernmental relations, the history of cooperation with neighbouring municipalities, and other factors. The appropriate governing structure is also influenced by the attributes of the population it is intended to serve, such as the degree of ethno-cultural diversity.

Two-Tier Model

The two-tier model consists of an upper-tier governing body (usually a region, district, or metropolitan government) encompassing a fairly large geographic area and lower-tier or area municipalities (including cities, towns, villages, townships etc.). The upper tier provides region-wide services characterized by economies of scale and externalities whereas the lower tiers are

responsible for services of a local nature. In this way, two-tier models help to resolve the conflict among the various criteria for designing government structure -- economies of scale, externalities, and redistribution on the one hand and subsidiarity, access and accountability on the other (Barlow, 1994).

Redistribution throughout a city-region is achieved at the upper-tier level through a combination of tax and spending policies. On the tax side, tax rates are generally levied at uniform rates across the region and the contribution of each lower-tier municipality to the upper-tier municipality depends on the size of its tax base. The larger the tax base in any one municipality, the larger is its contribution to the upper-tier government. On the spending side, the upper-tier government makes expenditures on region-wide services. These expenditures benefit the entire city-region and are not necessarily distributed among the lower-tier municipalities in the same way as the tax revenues are collected. The result is that a uniform property tax at the upper-tier level, combined with region-wide expenditures, serves to redistribute resources from the relatively large tax base municipalities to the relatively small tax base municipalities. There will, however, still be differentiation in service levels and tax rates for services provided by lower-tier municipalities.

With two-tier governments, it is necessary to allocate functions among the tiers. To do this, the above criteria for governing structure can be applied. The upper tier should be responsible for services that provide region-wide benefits, generate externalities, entail some redistribution, and display economies of scale. Services that provide local benefits should be the responsibility of the lower tier. Although there are differences across regions, generally the regional government is responsible for arterial roads, transit, policing, water and sewers, waste disposal, social services and social housing, and regional planning and development. The lower tier is responsible for local roads, fire protection, waste collection, parks, recreation and libraries, and local planning and development. In all cases, taxes are collected by the lower-tier municipalities. Generally, borrowing is done at the regional level.

Two-tier systems permit any desired degree of redistribution but also have potentially important advantages in terms of accountability, efficiency, and local responsiveness. Critics of the two-tier model, however, argue that costs are higher because of waste and duplication in the provision of services by two levels of government. Furthermore, two-tier levels of government are less transparent and more confusing to taxpayers who cannot figure out who is responsible for what services. Finally, two municipal councils are said to lead to “considerable wrangling, inefficiency in decision-making and frequent stalling or postponement of the implementation of policies that would benefit taxpayers across the entire local government jurisdiction” (Kitchen, 2002).

There are many examples of two-tier systems in Ontario where there is an upper tier (such as a regional government or a county) and a lower tier (such as cities, towns, villages, and townships). These include: Durham, Halton, Niagara, Peel, Waterloo, and York. The District of Muskoka and the Restructured County of Oxford are also regional systems. In the last few years,

a number of two-tier regional governments were disbanded and the lower-tier municipalities amalgamated into single cities: Ottawa-Carleton, Hamilton-Wentworth, Sudbury, and Metropolitan Toronto. The Regional Municipality of Haldimand-Norfolk was split into two single-tier municipalities (Haldimand and Norfolk).

One-Tier Model

Under the one-tier model of urban governance, a single local government is responsible for providing the full range of local services and has a geographic boundary that covers the entire urban area or city-region. In theory, these boundaries move outward as the urbanized area expands; in practice, however, this is seldom the case. Historically, municipal boundaries have been inelastic, leading to the typical fragmentation of an urban region into city and suburban municipalities (Bourne 2003).

Large single-tier governments have generally been formed by *amalgamation* (merger of two or more lower-tier municipalities within an existing region) or by *annexation* (appropriation of a portion of a municipality by an adjacent municipality). Since there is only one level of government providing all of the municipal services, there is no need to allocate expenditures among levels of local government (as in the two-tier model). One-tier governments could provide a wide range of services. These could be financed from a variety of user fees and tax sources that would be levied across the metropolitan area in the same way that the upper-tier municipality would finance services in the two-tier model.

One-tier cities can mean that uniform services are provided throughout the urban area but this is not necessary. Particularly where the one-tier municipality has been created from the amalgamation of several municipalities, there is the option of maintaining the different services and service levels that existed in different parts of the city-region prior to the creation of one tier. For example, rural residents will not necessarily receive all of the services available to urban residents.

Where property taxes are used to finance services, special area rating can be used for those services where beneficiaries are restricted to specific areas. For example, if garbage collection is only provided in the urban parts of the municipality, then a special area rate for garbage would be levied on urban residents. All residents would pay the same general property tax rate; those in urban areas would pay the general rate and the special area rate.¹⁴

In short, since services are not necessarily standardized across the new municipality, tax rates should also not be standardized. There is an opposing argument, however, that one of the reasons for amalgamation is to create one jurisdiction that encompasses the entire city-region and that

¹⁴ Special area rating has also been used to ensure that differences in reserves and debt of the constituent municipalities are reflected in their tax rates.

differences in service delivery and tax rates should not be maintained past a short transition period.

The main advantages that have been cited for one-tier governments that cover the entire urban region include: better service coordination, clearer accountability, more streamlined decision-making, and greater efficiency (Boyne, 1992, p. 333). They might also facilitate long-term planning and budgeting. Furthermore, there is likely to be funding fairness in the provision of services because there is a wider tax base for sharing the costs of services that benefit taxpayers across the region. The larger taxable capacity of the one-tier government increases its ability to borrow and to recover capital and operating costs from user fees (Bahl and Linn, 1992, p. 415).

There is little dispute over the advantages of better service coordination, streamlined decision-making, and funding fairness. From an efficiency perspective, municipal amalgamations have the potential to internalize externalities. For example, rural residents outside of the original municipal boundary would now pay for urban services that they use.¹⁵ Large one-tier governments can also take advantage of economies of scale in service provision.

There is some debate, however, over the success of a large one-tier government at achieving accountability and efficiency (in terms of cost savings). In terms of accountability, a large-scale one-tier government reduces access and accountability because the jurisdiction becomes too large and bureaucratic, especially if it is large enough to contain spillovers and provide a basis for rational regional planning. In some cases, community committees are established to address local issues or satellite offices are distributed across the municipality where people can pay tax bills, apply for building permits, etc.¹⁶ These committees and satellite offices likely increase

¹⁵ Municipal restructuring is only the first step in linking taxes to service benefits by ensuring that the beneficiaries are located within the jurisdiction providing the services. The second step is to identify the benefits received by residents and to tax them accordingly. For example, while it is fair to charge rural residents for their use of urban services such as recreation facilities and libraries, it is not fair to charge them for garbage collection if they do not receive it. See Vojnovic (2000, p. 54).

¹⁶ In 1971, the City of Winnipeg and its twelve area municipalities were amalgamated to form a single city. Even with its residents' advisory groups (RAGs), it was felt to lack responsiveness and accountability. These groups were subsequently abolished. See Smith (1995, p. 168) and Sancton (2000, pp.62-3). Another example is Montreal where the provincial government merged the City of Montreal with a population of 1 million and 27 other municipalities on the island of Montreal (with a total population of 800,000) effective January 1, 2002. The new city is divided into 27 boroughs, each responsible for local services such as garbage collection, swimming pools, snow clearing, and libraries. Nine of the boroughs are located in the central city where none existed previously. Thus, although residents of the ex-suburbs have lost control over some municipal services, residents of the former City of Montreal have gained more autonomy.

accessibility but it is less clear how they impact on accountability. Furthermore, they reduce any potential cost savings that might result from a larger government unit.

In terms of efficiency, evidence from municipal amalgamations suggests that cost savings are elusive (Slack, 2000, p. 24). Although the reduction in the number of politicians and bureaucrats reduces costs, there is also a tendency for expenditure increases when municipalities with different service levels and different wage scales merge. Service and wage level harmonization generally mean that expenditures increase to the level of the highest-expenditure municipality.

A review of the empirical evidence in the U.S. on fragmented versus consolidated local governments concludes that lower spending is a feature of fragmented local government systems; consolidated structures are associated with higher spending (Boyne, 1992, pp. 344-46).¹⁷ One of the reasons is that amalgamation tends to reduce competition between municipalities because there is less incentive to be concerned with efficiency and less incentive to be responsive to local needs. The lack of competition can reduce efficiency in the delivery of services and result in higher costs.¹⁸ Another reason for higher costs, and an important equity consideration, is that there is likely to be an increase in the quality of services provided in the smaller and poorer municipalities.

There are two types of examples of one-tier municipalities in Ontario. There are those that were created through the amalgamation of regional and lower-tier municipalities, as noted above, and separated cities that were always one tier. Separated cities in Ontario include, for example, London, Windsor, Sarnia, Kingston, and Brantford. These are cities that are located in a county but are not part of the county system. They are responsible for delivering all municipal services within their own boundaries.

Voluntary Cooperation

Voluntary cooperation has been described as “minimal” government restructuring in which there is an “area-wide body based on voluntary cooperation between existing units of local government in the agglomeration with no permanent, independent institutional status” (Sharpe, 1995, p. 12). These are very common in the U.S. and France, in part, because they are easy to create politically and can also be disbanded easily. The voluntary model is included under governance of large urban areas even though it does not include an elected, area-wide government. It is included because it recognizes the inter-relationship of municipalities within the region with some form of area-wide arrangement.

¹⁷ Sancton (1996) reviewed municipal consolidations in three Canadian provinces and concluded that the evidence does not support the view that consolidations result in cost savings.

¹⁸ As noted in our paper on Communities at Risk, some forms of competition between municipalities can be wasteful of resources, however. Examples include tax incentives and other strategies to attract development.

Cooperation can take different forms and includes administrative integration as well as political integration in that there is some form of representation on the boards from the member local governments. These organizations can levy taxes or collect contributions from the municipalities or they can levy user fees to pay for services.

Voluntary cooperation is an alternative way of providing services across a region without resorting to amalgamation. Municipalities can retain their autonomy with respect to expenditure and tax decisions but, at the same time, achieve economies of scale in service delivery and address externalities associated with service provision (Sharpe, 1995, p. 13). There can be problems of accountability, however, when services are provided by another jurisdiction. Redistribution throughout the urban area is not automatic in a system of voluntary cooperation.

The voluntary model can work well when policy objectives are shared by all policy-makers in the various local governments. Thus, there would be no need for any additional institutional arrangements. It may not work so well, however, when there are divergent objectives and when there are wide differences in local resources. Cooperation usually involves bargaining and some municipalities may not have anything to bargain with. The problems faced by large urban areas are significant – global competition, fiscal disparities, sprawl – and the solutions may require them to rely on a structure that has a permanent institutional status rather than a voluntary arrangement.

There are no models of voluntary cooperation in Ontario but the Greater Vancouver Regional District (GVRD) is an often-cited Canadian example.¹⁹ The Greater Vancouver Regional District was created in 1967 as part of a system of regional governments established by the provincial government in British Columbia at that time to increase municipal cooperation without introducing a new level of government. The GVRD comprises 18 municipalities as full members and three unincorporated areas. Its responsibilities include borrowing for municipalities, hospitals, planning, air pollution control, parks, solid waste disposal, public housing, collective labour relations, and public transit (the latter added in 1999). GVRD funds come from the member municipalities by billing them for services rendered. The cost of most services is apportioned among member municipalities on the basis of the property assessment base. Other regional costs are contained in municipal charges for water, sewer, and solid waste.²⁰

Regional organization in the Vancouver area has always been characterized by voluntary participation of individual municipal governments and an approach of consensus building. As Oberlander and Smith (1993, p. 333) note, “metropolitan governance has emerged in place of metropolitan government in the Vancouver region; that is, metropolitanwide services and their spatial implications are managed regionally in the absence of metropolitan government.” The

¹⁹ This description is based on Slack (2001).

²⁰ Unlike city-regions in Ontario, social services are funded entirely at the provincial level in B.C. This means that redistribution is done on the provincial scale.

difference between regional governance and regional government is that a government is characterized by representation, revenue-raising capacity, autonomy, authority, and the capacity to coordinate multiple functions (Oberlander and Smith, 1993, p. 367).

The advantages of the Vancouver model are that it preserves local autonomy, diversity, and the distinct identity of its member municipalities. Problems have arisen, however, because of the lack of authority to implement policies. In the area of planning, for example, the master plan in 1994 promised to slow down the disappearance of farmland, concentrate housing and build rapid transit. But none of the municipalities are obligated to respect the plan. Another disadvantage is that it is often ineffective in ensuring that regional concerns are taken into account in local decisions. No one speaks for the region;²¹ it can only do what is delegated to it by its member municipalities.

Inter-Municipal Agreements

Inter-municipal agreements are formal or informal agreements between municipalities to provide services. They are a type of voluntary cooperation but are less structured in that an official area-wide body is not generally set up to oversee the arrangements. These types of agreements have generally been effective for services such as fire fighting and emergency dispatch, maintenance of boundary roads, purchasing in bulk, and issuing debentures. Agreements are generally entered into as a way of reducing costs or to set out joint obligations for different municipalities.

Inter-municipal agreements work well for small services that can be contracted out or to share costs. They are not a solution, however, to the need for region-wide coordination. Furthermore, inter-municipal agreements provide no accountability except through the contract or agreement. If something goes wrong, it is difficult for citizens to know where to complain – to their local government or the local government that has been contracted to provide the service. Inter-municipal agreements also increase the likelihood of inter-municipal litigation and conflicts (GTA Task Force, 1996, p. 163).

Although inter-municipal agreements may be successful in achieving coordination and efficiencies for specific services, they are not suitable for achieving region-wide coordination nor cross-municipal redistribution. Inter-municipal agreements have been described as second-best solutions to reorganization that can lead to “an impenetrable jungle of *ad hoc* commissions and complex arrangements that even the most conscientious municipal voter will never understand” (Sancton, 1993, pp. 33-34).

There are a number of inter-municipal agreements in Ontario but these are mainly found in smaller municipalities. For example, smaller municipalities may share a treasurer or engage in cooperative purchasing to lower costs. Many municipalities cooperate on fire services through Mutual Aid agreements.

²¹ The Chair and the board members are part-time regional politicians.

Special Purpose Districts

Special purpose districts to deliver services that spill over municipal boundaries provide another alternative to altering municipal boundaries. Single-purpose special districts provide similar municipal services for several municipalities or manage regional services with significant externalities, such as garbage disposal. This form of cooperation among municipalities for region-wide services is used in countries where there is a history of strong and autonomous local governments. In the U.S., for example, one third of local governments are special districts or school districts providing education, transportation, water and waste management, economic development, and other services. Joint boards of the special districts are responsible for the management of these services as well as taxing, price setting, and other policy-making. These districts are indirectly controlled by the individual municipal councils.

One of the advantages of special purpose districts is that each service spillover can be addressed on an individual basis. Since it is unlikely that the spillover boundaries are the same for each service, separate districts could be established such as a region-wide transit district or hospital district.²² Other advantages include the following: the delivery of services by professionals with decision-making somewhat removed from political influence; services can be provided using more professional expertise than may be available to the municipal government; and dedicated revenues from user fees could be used to finance capital expenditures (Bahl and Linn, 1992, p. 407).

Several problems with special purpose bodies have been identified: First, each body has responsibility for a single service and is not required to make the tradeoffs between, for example, expenditures on transit and expenditures on water and sewers. Second, the proliferation of decision-making bodies has “created a diffuseness of government organizations that is difficult for citizens to understand” (Kitchen, 1993). There is no citizen control and confused accountability. Third, there is no direct link between the expenditure decisions made by the special purpose agencies and the local council that collects property taxes to fund them. The absence of a link between expenditures and revenues seriously reduces accountability. Fourth, where accountability is lacking, there is no incentive to be efficient. Fifth, when there is a large number of independent special purpose bodies, it is difficult to coordinate interrelated activities.

²² Special districts are an example of functional, overlapping, competing jurisdictions (FOCJ), a concept that has been proposed for Europe. It envisages that “welfare could be improved substantially by promoting competition between newly emerging jurisdictions that are organized along functions instead of territories.” These would be governments in that they would have enforcement power and would be able to levy taxes; they would extend over areas defined by the functions they are responsible for; they would overlap geographically; and individuals, and communities could choose which governmental unit they wanted to belong to (Frey and Eichenberger, 1996, p. 315).

Three ways have been suggested to address the problems of coordination (Bahl and Linn, 1992, p. 419). The first is to have overlapping membership so that some of the same people are on a number of district boards. The second is to encourage the formation of districts with multiple functions instead of single-purpose districts. The third is to control the operations of the districts so that they remain separate authorities but are still subject to political considerations in the decision-making process.

The experience in the UK with special purpose districts, and other non-elected bodies charged with the responsibility of implementing government policy and providing urban services, is sobering. As part of the process of decentralization, and in order to make the public sector more efficient, the UK central government has for some time turned over the delivery of certain public functions to non-governmental organizations. These have become widely known as quasi-autonomous non-government organizations, or QUANGOs, or more recently they have simply been called extra-government organizations or EGOs. There are an estimated 5,500 of these organizations in the UK, of which over 4,700 operate at the local level, and they are said to manage nearly one-third of all government expenditures (Amos 1996).

While there is clearly a role for such organizations in any modern system of government, the danger, as the British example illustrates, is that these are generally run by appointed rather than elected individuals and they are not subject to the same regulations as government agencies with respect to accountability, public access and information provision. The result has become a form of 'shadow government' that, in addition to being unelected, is largely unaccountable and secretive. As a result they also reduce the level of democratic accountability and representation in the delivery of services and more broadly in the governance of civil society.

4.4 Conclusions on Governance Models

It is difficult to conclude what is the best model of governance for large urban areas or city-regions: "no model stands out as clearly superior in all respects" (McMillan, 1997, p. 39). Application of the criteria for designing government structure outlined above to the various models presented, however, suggests the following:

- ∅ Some form of regional structure that encompasses the entire city-region is needed to address problems of a region-wide nature such as fiscal disparities among municipalities and problems associated with externalities in service provision. A regional structure is also necessary to provide the appropriate scale for co-ordination of infrastructure and land use planning decisions
- ∅ Although the need for a regional structure is clear, the form it takes will vary with local circumstances (e.g. one-tier or two-tier). Inter-municipal agreements for the provision of services are effective for a small number of services but do not provide a solution to the need for regional cooperation.

- ∄ A two-tier structure may achieve greater efficiency than is likely to be attained in a more centralized one-tier structure. Desirable economies of scale and scope can be realized at the upper-tier level while at the same time the lower tier permits more responsiveness to local variations in preferences. This model maintains the close linkage between local financing and spending decisions.
- ∄ A one-tier structure is simpler to understand and more transparent than a two-tier structure. Two-tier structures are inherently more complex and may result in undesirable duplication, overlap, and general confusion among citizens as to who is responsible for what and who is paying for it.
- ∄ Where local autonomy is paramount and where objectives are shared by policy-makers in various local governments, voluntary cooperation can work. It works less well when objectives are different among local governments and when it comes time to implement those goals. It also works poorly when there are wide differences in the attributes of local municipalities, and for particular kinds of services such as social housing and public transit.

5 CONCLUSIONS: IMPROVING THE ABILITY OF CITIES AND CITY-REGIONS TO RESPOND TO EMERGING CHALLENGES

In this section we offer a summary of recent trends in three spheres – economic, social and fiscal – and identify some of the challenges these pose for provincial, sub-provincial and municipal governments. We then combine this summary with a series of recommendations designed to enhance the ability, capacity and flexibility of our cities and city-regions, their institutions and political jurisdictions, to respond to these challenges and to take advantage of opportunities for improvements in economic competitiveness, social cohesion and financial viability, while augmenting the democratic process, maintaining political accountability, and improving the overall quality of urban life.

5.1 General Propositions

1. Vibrant cities and city-regions are defined here to encompass the economic vitality, social cohesion and fiscal viability of urban communities, which are in turn, supported by an effective, efficient and equitable system of institutions and structures of governance, and by a robust civil society.
2. It is not possible, however, to separate completely the economic, social, fiscal and institutional domains of contemporary urban life. All of these domains are interrelated; change in one domain can and does influence change in the others. But they do not

necessarily have the same geographical dimensions or jurisdictional requirements.

3. The Province of Ontario is now overwhelmingly urban in terms of its economy, culture and life styles, and in the living environments it provides for its residents. It follows that urban areas – cities and more broadly city-regions – are increasingly the principal drivers of economic prosperity in the province, the setting for most innovative energy, the locus of social change, and the places where the impacts of societal shifts are most intense and visible.
4. Governments, and more broadly the structures, rules and practices of governance, are important components in nurturing, accommodating and adapting to economic and social change. The form and quality of governance do matter.
5. The current institutional, fiscal and political structures of the province, however, seem to be increasingly out-of-balance with respect to the province’s rapidly evolving economic and social landscapes.
6. All political structures are territorial, in the sense that politicians represent people in specific and bounded areas or regions. All administrative agencies and service-providers have specific areas of responsibility, and most public goods and services are provided to people where they live. Thus, place and location are crucial issues here.
7. Many of the major social and economic challenges facing the provincial government, its agencies, and its cities and city-regions cannot be effectively addressed at the local or municipal level, although each level has a role to play. Most of those challenges have their origins, their major impacts, and their potential solutions at scales that typically exceed the boundaries and jurisdiction of local or lower-tier governments.
8. In addition to standard arguments of improving economic efficiency and public sector fiscal (and political) accountability, any new design of the structures of urban and regional governance must consider arguments based on equity, fairness and collective responsibility. In this case, equity means both vertical (among citizens) and horizontal (among places and regions) equity.

5.2 Challenges and Opportunities

1. The principal challenge facing the province is to find the means of addressing the scale and rapidity of change and specifically the unevenness of urban growth, economic prosperity and social change, set in a period of intense international competition, rapid technological innovation and rising social demands and expectations. In most instances this means adapting the structures and practices of government to new urban realities.

2. Among the principal economic challenges facing the province and its varied municipalities are heightened international competition, the transition to a knowledge-intensive economy, and the intensified battle for highly educated and creative workers. These put pressure on Ontario to offer world-class infrastructure, excellent public services (especially health care and education), and a high quality of place as efficiently and cost-effectively as possible. Efficient, well-planned urban form constitutes one of the bedrocks for such conditions to be met.
3. The social challenges facing the province and its cities and regions are also varied and complex, which in turn call for a flexible approach. These trends include a slower rate of population growth, which will result in declining populations in much of the province, the continuation of the demographic transition, resulting in an aging society, increasing social and ethnic diversity, largely through immigration, and the concentration of poverty and marginalized groups. The effects of these changes, and their implications for public policy, will also be very uneven across the province.
4. The impacts of an aging society, for example, will be most strongly felt in smaller and slow-growing cities that by definition are the least able to respond to the servicing needs generated by their resident population.
5. Urban growth in the province – in terms of both population and the labour force – is increasingly driven by immigration, and thus by conditions and decisions made outside the province. This, in turn, increases the uncertainty of population growth and forecasting of future needs. At the same time, the social and physical character of our cities will have a major influence on their ability to attract and retain immigrants.
6. Immigration flows are also highly concentrated geographically within the province. As a result those cities and city-regions that attract immigrants will grow, and become much more ethnically diverse, while those that do not attract immigrants are likely to decline. Servicing levels and structures of governance cannot be the same in both types of communities.
7. The ethno-cultural diversity added to Ontario's cities and city-regions by immigration also offers immense opportunities to enrich social life and economic vitality, but poses a huge challenge in ensuring the full participation of members of these groups in civil society and in the political process. This is often most effectively done at the local level.
8. Given that immigration is now the major component of urban growth in the province, and the major driver of metropolitan growth and concentration, it is imperative that the costs and benefits of accommodating this new population should be shared by the entire province, indeed the country. For cities receiving most of the immigrants, the strain on their local budgets is intense.

9. Current estimates are that the federal government provides approximately \$1,000 to \$1,500 per individual for immigrant settlement assistance. This is an inadequate level of support in terms of the costs of hard and soft infrastructure to accommodate that population. One priority is to ask the federal government to provide more realistic support for regional/local governments who receive and integrate new Canadians.
10. Among the principal fiscal challenges facing cities and city-regions is the requirement to provide the services they need to be competitive and to provide their residents with healthy, safe and pleasant places to live, with the fiscal resources available to them. Both needs and resources vary widely from place to place. For example, municipal expenditures tend to be higher in large places because they have a more sophisticated transportation system, more specialized police and fire services, larger demands for social services, and more arts and cultural facilities. Moreover, large cities are required to provide these services with a limited set of tax tools (largely the property tax and user fees). The result is that cities either have to increase property taxes and fees or let service quality and the state of the infrastructure deteriorate.

5.3 Conclusions and Recommendations

Maintaining vibrant cities and city-regions requires structures of governance, public policies, and tax regimes that encourage and accommodate economic innovation and competitiveness, that are able to adapt and respond to massive social and cultural changes, and that ensure both social equity and a high quality of life. Vibrant cities and city-regions, defined above as embracing economic vitality, social cohesion, and a robust civil society, require sub-provincial units of government and administration that have the capacity, financial resources, policy tools and expertise to address their particular needs, and to take advantage of unique opportunities, in each of these fields.

This final section of the paper draws conclusions and makes recommendations in three general areas: demographic change and uneven growth and decline, finance, and governance.

5.3.1 Demographic Change and Uneven Growth and Decline

1. An aging and increasingly diverse society will increase the demands for specialized services, especially in health and education fields. Many of these costs will have to be borne by the province or larger regional governments rather than local governments.
2. The provincial government will have to find ways and means to deal with a polarized pattern of growth – with *concentrated growth* of population and jobs in a few metropolitan areas, or city-regions contrasting with *decline* almost everywhere else. Processes of social and demographic change outlined above virtually ensure that the

differences between growing and declining places will increase. The challenge is how to make both growing and declining cities more “vibrant”, more competitive, and more pleasant places to live. In our second paper, “Communities at Risk”, we examine in more detail the specific challenges facing rural areas, small towns and cities on the periphery of the province.

3. For those cities and city-regions that are facing stagnation and decline there seems to be *no substitute for direct provincial action* and support in assisting those regions to remain vibrant and to offer reasonable levels of service provision and a reasonable level of quality of life.

5.3.2 Finance

1. Vibrant cities and city-regions do not have adequate resources to meet their growing expenditure requirements. Increased demands for services and infrastructure and the growing reliance on an inelastic property tax base, clearly threatens the future financial viability of the major city-regions. This situation is, at least to some extent, the result of a misalignment between expenditures and revenues. There is thus a need to *revisit the allocation of expenditure responsibilities and revenues* between the provincial government and its cities to ensure that there is an appropriate balance between them. Most significantly, funding social housing a portion of social services from property tax revenues needs to be re-considered.
2. Cities and city-regions also need to *make use of their existing revenue sources more effectively* (Slack, 2002a). They need to make greater use of user fees, and, equally importantly, they need to restructure those they now have in order to ensure the efficient use of services. This means, for example, that services such as water, roads, and transit must be priced to reflect the marginal cost of providing them. In addition, when it comes to financing new infrastructure, development charges should be imposed on a development-by-development basis to encourage efficient land and infrastructure use and to ensure that developments are located closer to existing services. Proper pricing will reduce the need for some infrastructure investment and also provide a source of finance when it is needed.
3. City-regions also need *access to tax sources* other than the property tax and user fees. The choices include: income taxes, general sales tax, and selective sales taxes (fuel tax and hotel/motel occupancy tax, for example). In each case, the costs of administration will be significantly less if the local tax is piggybacked onto the provincial tax. It is essential, however, that large cities and city-regions levy their own tax rates based on their revenue needs. Only with *tax rates set by the cities and city-regions* themselves (rather than provincially-set rates) will there be local autonomy and accountability for local expenditures and revenues.

4. Based on current experience in other provinces and countries and based on reviews of the effectiveness of different tax sources at the local level, *fuel taxes and hotel and motel occupancy taxes seem to show the most promise* for Ontario city-regions in the near future.
5. Although an income tax that is piggybacked on to the federal or provincial tax with locally set rates has some advantages in terms of local autonomy, accountability, and revenue elasticity, there are *problems with levying an income tax at the local level*. In particular, there are problems with taxing business income because of its mobility across municipal boundaries.
6. Although a general sales tax at the local level has some advantages in terms of taxing commuters and non-residents, a *sales tax has been rejected by some authors* on the grounds that the current retail sales tax, in provinces that have not harmonized with the GST, taxes production inputs very heavily and is detrimental to economic growth and competitiveness (TD Economics, 2002, 26).
7. Hotel and motel occupancy taxes and fuel surcharges have been recommended by a number of authors (Toronto City Summit Alliance, 2003, TD Economics, 2002, for example). Hotel and motel occupancy taxes (currently levied in Vancouver, Victoria, Montreal, and most US cities) are an additional levy imposed on the provincial retail sales tax rate on hotels and motels. The justification for this tax at the local level is to compensate cities for the services they provide to tourists or visitors such as additional police and fire protection, transit capacity, etc.
8. Fuel taxes have been recommended by TD Economics, the Federation of Canadian Municipalities, and the Toronto City Summit Alliance among others. If the funds are earmarked for local roads and transit, a fuel tax can be viewed as a benefits tax. Moreover, a fuel tax is likely to discourage road use and help curb urban sprawl. The best way to discourage road use would be to implement a fuel tax as part of an overall strategy to get users to pay the full cost of automobile use.
9. To reduce the incentive to stay in hotels or fill up on gas outside the taxing jurisdiction, it would be preferable to *tax on a region-wide basis*. Tax rates set on a region-wide basis will also reduce potential distortionary effects (such as people buying gas or shopping in a neighbouring jurisdiction to avoid the tax).
10. It is *not appropriate to give more taxing authority to all municipal jurisdictions* in the province. Large cities and city-regions are best suited to take advantage of new taxing authority; smaller cities are unlikely to be able to raise sufficient revenues from some of these sources to make the effort worthwhile. Moreover, smaller communities may face problems with the distortions noted above.

5.3.3 Governance

1. There is *no single model of governance*, no single strategy or policy for ensuring vibrant cities, that applies everywhere in the province. There is no “one-size fits all” model. For example, the current situation, and emerging challenges facing the Greater Toronto Area are different from those facing Ottawa, which are in turn different from those facing Kitchener-Waterloo, London and Windsor, and those differ from the challenges facing Brantford, Thunder Bay or Sudbury.
2. The circumstances outlined above call for a *more flexible approach to governance*, and to provincial-local arrangements, an approach that mirrors differences in local and regional attributes and in the potential for sustainable growth and prosperity.
3. For most matters of current public concern – economic competitiveness, social cohesion, fiscal viability, as well as transportation and environmental issues – we have argued that *some form of regional governance structure is needed* that encompasses the entire city region. Few of these problems and processes stop at municipal boundaries; and most of the solutions require larger geographical units and access to a large pool of resources, both human and financial.
4. Some form of regional structure is also necessary to take full advantage of new and emerging opportunities for economic cooperation and for enhancing productivity and competitiveness in an increasingly knowledge-based economy. In addition to providing the best opportunities to accentuate the urban character and vitality of city-regions, a regional structure provides a strong focus for economic development strategies that enhance regionally-based competitive advantages.
5. There are a large number of different models for regional governance available, both in theory and in practice. Single-tier, two-tier, and various other models, have all worked successfully, to varying degrees, in different places. But the choice of model is not nearly as important as having a regional government structure in place.
6. For the GTA, there have been a number of studies that have recommended a two-tier structure (see, for example, the GTA Task Force, 1996; the Crombie Who Does What Panel, 1996, and Slack, 1997). The creation of the Greater Toronto Services Board (GTSB) in 1999 was a step along the way to two-tier government for the region but it was disbanded. In our view, recent changes in the GTA, as outlined in earlier sections of this paper, have substantially strengthened the arguments for a two-tier structure recommended in these earlier studies.
7. Our preferred structure of government for the Toronto region, at least the urbanized portion of the GTA, is a *two-tier elected regional government*. The upper tier would perform a limited number of functions; it would be responsible for services that spill over

municipal boundaries (such as transportation and land use, economic development and tourism, and social services). All other functions and responsibilities (particularly those where the benefits are enjoyed in local communities and where local preferences matter) would be delegated to the local level. These services would include, for example, parks and recreation, libraries, local roads, and local planning. To determine the specific functions that should be assigned to each level of government, a detailed study is required that is set within the context of the new economic, social and political realities of the GTA and builds on and extends the earlier work of the GTA Task Force and the Who Does What Panel.

8. The upper tier could cover the entire GTA or be limited to the highly urbanized (present and future) portions of the region. As both the GTA Task Force and the Who Does What panel recommended, there would need to be some amalgamations at the lower tier level to ensure that these municipalities are financially viable and able to deliver services effectively. In addition to the existing sources of municipal revenue, the region-wide body should have access to fuel taxes and hotel and motel occupancy taxes (as noted above). These taxes would provide at least some of the funding needed for transportation and tourism respectively. Lower tiers would continue to use property taxes, user fees, and other existing sources of local revenue.
9. A two-tier structure also seems appropriate for other city-regions with an inherited poly-nucleated urban form such as St. Catharines-Niagara, Kitchener-Waterloo-Cambridge, and Simcoe County. For other-city regions, where there is a smaller, mono-centric city surrounded by fringe development, one-tier regional government seems appropriate. Examples include London, Ottawa, Sudbury and Windsor.
10. Defining the boundaries of regional authorities and the lower-tier municipalities is always a challenge, and there is no single best solution. Given the highly political nature of the process of setting boundaries, it is recommended that an *independent tribunal* be set up to provide the provincial government with specific proposals for each region.

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