

## EQUITY AND FAIRNESS

Pricing instruments to manage future sprawl, if poorly designed, could unfairly affect lower income Canadians. This is an important concern, and not just for those with lower incomes and the fair-minded majority of Canadians; if this concern is not addressed, the proposed policy changes likely won't attract a wide enough constituency to be adopted.

User pay systems have a well-deserved reputation for being regressive in their impact. Since the 1980s and 1990s, many local and higher level governments have gone through periods of imposing what have been called “user fees.” Often these weren't really user fees at all, but rather flat charges levied on a per-person, per-household or similar basis. Nor were they applied to reducing negative externalities; indeed, they were often levied against goods with positive externalities, such as health care (see Externalities discussion, above). Such charges were more akin to poll taxes (annual per-person head taxes) and, understandably, about as unpopular.

Applying a flat tax or charge unrelated to consumption carries little or no justification other than raising revenue. Intelligent design of pricing instruments can make them target the “bad” more accurately, and protect lower income people. For instance, raising property tax rates on single-family dwellings while reducing rates on multi-family rental dwellings (as some Montreal boroughs have done) will tend to be more progressive than flat rates, or rates that are higher on multi-family dwellings. Likewise, frontage rates for utilities will cost more for bigger properties, which – other things being equal – tend to be owned by people with more money.

Note the reference to “other things being equal.” Sometimes other things are not equal, and a particular instrument's revenue-raising side might have an unintended regressive consequence. For instance, a lower income person in a bungalow in an older part of town may have a 50-foot lot, while an expensive house sits on a newer 40-foot lot. The lower income person ends up paying a higher frontage rate than the owner of the expensive house.

The other side of the instrument, however, is revenue spending – and the revenue can be used in a way that makes the overall instrument neutral or even progressive (e.g., spending the revenue on income supports, transit subsidies or affordable housing).

Finally, an individual pricing instrument – even if it has a regressive impact in a particular case – can be part of a larger program of policy changes that overall is progressive. What matters is not whether an individual element of a particular reform package is regressive, but whether the package overall is more regressive than the alternative. Bearing in mind that property taxes have a regressive impact,<sup>158</sup> it is necessary to ensure that any revenue streams that replace it are at least less regressive, and ideally progressive.

A few simple principles could usefully inform a fair pricing guideline:

- Apply fees, charges and taxes to negative externalities, and subsidies to positive externalities.
- Design pricing instruments to provide “lifeline” or progressive rates, i.e., low or zero price rates for modest use of goods and services, and higher rates for larger quantities.
- Design pricing instruments to phase in transition to new prices, which will allow people to plan ahead in order to reduce disruption.
- Design pricing instruments to “grandfather” some prices for existing uses, or exempt qualified ratepayers (e.g., where a user fee or a shift in property tax structures could hurt retirees on fixed incomes).
- Where a pricing instrument cannot be designed to have a progressive impact, employ the revenues from it, or develop a companion instrument or program of instruments, to provide compensation for lower income people (e.g., use road tolls to subsidize transit, or provide income assistance).
- Employ a review lens of fairness and political acceptability in all stages of pricing implementation: issue identification, instrument selection, instrument design and communication.

Finally, in addition to considering the impact of individual policy instruments, it is important to bear in mind the overall distributional impacts of sprawl pricing. By reducing further sprawl, pricing helps to reduce vehicle use and smog emissions that harm lower income people disproportionately.<sup>159</sup> By making housing in central areas with good transit less expensive, it provides living arrangements that are truly more affordable (rather than distant houses with low sticker prices and expensive automobile dependence).

## DIVERSE INCENTIVES

As shown, there are many tools available to municipalities to help reduce future sprawl and create more liveable communities. Employing a diverse range of tools is useful, for many reasons.

First, adopting a range of policies sends a clear signal about the overall policy direction of the (municipal or other) government. For example, the City of Kitchener, Ontario has signalled that it wishes to “facilitate the reurbanization of developed areas of the city, including the downtown and central neighbourhoods, by stimulating private sector investment in the reuse of vacant and underutilized lands,” and to that end, it is offering a “comprehensive package of financial incentives.”<sup>160</sup> A clear signal about the government’s intentions can influence private planning and investment decisions – above and beyond the influence of the pricing instruments adopted.

Second, the tools have different types of impact. For instance, distance-based pricing of road use provides an incentive to reduce distances driven but not to avoid driving during rush hour (dynamic congestion charging can do this). Likewise, property tax adjustments can be used to alter the ongoing cost of home ownership but have no direct effect on the very important up-front sticker price (development charge adjustments work better here). All of the tools have useful effects, but none is a silver bullet. Using a variety of instruments will help create a range of helpful incentives.

Third, it is unlikely that the implementation of any single instrument would result in a significant change in the pattern of suburban development. The price differentials between central and suburban housing are simply too large (in the hundreds of thousands of dollars in many cities) in comparison to the impact that a single pricing instrument would have. For example, the central-suburban price differential is often an order of magnitude larger than development charges, so tackling development charges alone would likely have an inadequate impact. In order to generate adequate incentives to manage sprawl, municipalities are going to have to use several instruments.

Fourth, the degree of impact of price changes on behaviour (“price elasticity,” in economics jargon) can vary over time. For some price changes, the behavioural impact could be high at first, but wane over time as people become accustomed to paying the new price. For others, the impact could increase over time, as people make investments that help them change behaviour to take advantage of the new price. Price elasticities can be estimated for the short term and the long term, and their variance over time may create a need for complementary pricing instruments.

Fifth, using a range of pricing tools at a relatively low rate creates less economic distortion than using just one or two

at a much higher rate. Generally, a broader tax base leads to greater economic efficiency than a single large tax.<sup>161</sup>

Sixth, politically, some of these tools can be considered low-hanging fruit, worthy of implementation in the short term. Other tools may be more effective, but require more time, effort and collaboration to overcome political challenges. Moreover, shifting politics can result in the adoption of some tools being more acceptable at different times. Moving forward on a range of proposals is less risky than depending solely on one.

Finally, adopting a package of pricing tools will enable any potential disadvantages of one to be offset by others. For instance, if one instrument had a regressive impact in a particular case, it could be offset by progressive impacts of others.

Municipal governments use their own criteria to evaluate what mix of policy instruments to employ. These will typically include the effectiveness of the instrument at helping to achieve the goal, other impacts (side effects), political challenges to adoption or implementation, economic efficiency (sometimes via cost-benefit analysis), administrative efficiency and cost-effectiveness, fairness, and any externally imposed obligations.<sup>162</sup>