

RYERSON UNIVERSITY AND UNIVERSITY OF CALGARY

**Tax, Borrow and Spend: Municipal Finance in Ontario, 1886-1941**

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### ***1.1 Introduction***

“Tax, Borrow and Spend” is the title of Gillespie’s now classic study of the financing of federal spending in Canada (Gillespie 1991). This phrase can be equally aptly applied to describe the evolution of the finances of the local level of government in Ontario, a long neglected subject during the post-Confederation period, the inter-war boom and the Great Depression based on a new data set compiled from provincial and municipal records. Significant urbanization enabled by technological change and exogenous economic shocks during this period shaped the contours and the institutional framework of local fiscal effort. Municipalities acquired new spending responsibilities, had their access to revenue bases narrowed, and by becoming dependent on the capital market for smoothing the financing of infrastructure, reinforced the deepening of the Canadian financial market. Further, until the end of the period under review, the aggregate local public finance sector was of greater quantitative importance than the provincial one. Despite the fact that “urban affairs are back on the agenda” in Canada and in a rapidly urbanizing world, there has been little by way of systematic examination of the roots of municipal finance in Canada and its development over time.

In this period, the financial development of Ontario municipalities was similar to that occurring in the United States and elsewhere. The assignment of the property tax as a benefit tax appropriate to fund the investments of local government in service provision was common to both Canada in the post- confederation era and in American states in the ante-bellum period (Perry (1955) and Wallis (2001) respectively). As with American cities (Legler, Sylla, and Wallis 1988; Holcombe and Lacombe 2001 and 2004), Ontario municipalities grew into their revenue base, continuously increasing per capita taxation in real terms until a peak was reached in the midst of the Great Depression. A similar pattern also characterizes borrowing and

spending. At the same time, the fiscal framework for public elementary and secondary education system was interwoven into the provincial-local relationship. Local provision of first elementary and then secondary schooling that was locally tax financed on a shared property tax base was established within provincially set parameters paralleling developments in the northern parts of the United States (Goldin and Katz 2008).

Despite a long tradition in Canadian economic historiography of the importance of the state and of metropolis-hinterland interaction in the economic development of the country (Easterbrook 1990), the actual role of local government and its financial development has largely been ignored. The specifics of the development of the actual mechanics of the structure and fiscal framework of local governments in their capacity of taxing powers and service providers has largely been ignored. While the relative importance of the aggregate of the local government sector relative to the other two levels of government measured by size diminished somewhat, it is clear that the municipal fiscal system developed the capacity to expand to meet the pressures of both urbanization and exogenous economic shocks during this period.

## *1.2 Summary of Data Sources*

To begin to address this gap in our understanding of the development of sub-national public finance, a new data set covering sources of revenue, expenditures and indebtedness derived from primary sources, both provincial and municipal has been constructed to enable the analysis of trends in revenues and expenditures of local governments in Ontario.<sup>1</sup> The data are used to show the changing composition of revenue sources as well as expenditure pressures faced by local governments during the late nineteenth and early twentieth centuries.

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<sup>1</sup> The data set is available upon request. The categories used are broadly consistent with current categories used by Statistics Canada and the Ontario Ministry of Municipal Affairs and Housing. The sources and derivation are described more fully in a separate appendix.

In the first two decades after Confederation, the Province published aggregate and municipal level data on the finances of Ontario municipalities only occasionally. Fragmentary data exist for three years (1868, 1877 and 1881). Data on education finance are more complete, as a consequence of having financial matters under provincial control. More consistent municipal data are available for the period after 1886, albeit with changes in reporting format and coverage with the establishment of the Ontario Bureau of Industries in 1882 and its expanded efforts at data collection. The level of detail improves significantly during the 1930s as the Province responded to the crisis in municipal finance in the Great Depression. This data also underlie the comparative fiscal tables to be found in the Report of the Royal Commission on Dominion-Provincial Relations (1940) (hereafter Rowell-Sirois report) and as a basis for Urquhart's (1993) estimates of government spending as a component of the estimates of gross national product from 1870 to 1926.

### ***1.3 The Institutional Context for Finance and Governance***

#### ***Finance***

##### ***The Establishment of Property Taxation: Both Real and Personal<sup>2</sup>***

One of the earliest measures taken in the establishment of Upper Canada was to enact authority to assess and tax property. The first *Assessment Act* of 1793 provided for a “moderately graduated tax on total property, real and personal.” In 1838, the *Act* was amended to specify that real property be assessed at 20 percent of its value and income at full value. This version was replaced in 1849. Provisions that would have included most income as personal property in the tax base, which had been in a draft Bill of 1843, largely copied from law of the

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<sup>2</sup> This discussion is based on Ontario Committee on Taxation, (1967, v. II., 30-32), the Smith Committee and Perry (1955, 587).

State of New York at that time, were eliminated. The assessment of personal property was confined to a short specified list which included only horses, cattle, carriages for pleasure or for hire, stock of merchants, mechanics, manufacturers and stock or shares in water craft for freight or passengers. Upon petition, annual rental value could be substituted for capital value as the basis of assessment of real property in towns and cities.

From 1850 to 1853, various modifications were made, which continued the annual rental value of real and personal property basis of assessment in cities, towns and villages (described as “rack rent”); capital value in counties and townships; and the taxation of income over £50 taxed as personal property unless exceeded by amount of other personal property. The annual rental value of personal property was regarded as equal to 6 percent of its capital worth. The *Act* also provided in detail for administrative matters such as the provision of notices and for appeals. Further, the responsibility for assessment was transferred to the local level. The *Act* also provided for the equalization of real property assessments for the purposes of the county levy.<sup>3</sup> From 1853 to 1866, little of significance was enacted (in the view of the Smith Committee). However, in 1866, capital value was made the mandatory basis for taxation of real property and earned and investment income subject to basic exemption of \$300 was to be added to personal property for taxation.<sup>4</sup> These rules prevailed until the significant reforms of 1904 eliminated personal property taxation.

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<sup>3</sup> Perry (1955, 34). Equalization refers to the factoring of assessments made at different valuation dates to a common portion of current market value at a common date. An amendment in 1851 specified the method for reconciling the assessments. Ontario Committee on Taxation (1967, v. II, 33) Equalization continued as a feature of the Ontario system until the major reforms of 1998.

<sup>4</sup> The estimated earnings per worker for an industrial worker in Ontario in 1870 were about \$245 in 1870. Drummond (1987, 427).

### *The Personal Property Tax*

Personal property was also assessed for local taxation and the system endured during the post-Confederation period. In Ontario, household effects and personal property valued at less than \$100 were never taxed. The personal property of companies was also exempt, but shareholders were taxed on the value of their shares. Perry characterizes the system as being riddled with anomalies and inequities.<sup>5</sup> All Dominion, provincial and municipal debentures were exempt from personal property tax but the interest income from these assets was taxed as income. Bank, loan company and railway shares were also exempted although the dividends from them were taxable. After 1880, the inconsistent treatment was removed and only dividends were subject to tax as personal property except those from railway shares which were completely exempt. By the 1880s, the tax had largely become a tax on the inventory of merchants as wealth increasingly took the form of “easily concealed intangible property”.

Dissatisfaction with this tax was evident in testimony at the hearings of the Select Committee on Exemptions from Taxation in 1878. The Treasurer of the City of Toronto suggested that the assessment of personal property was entirely fallacious and a local alderman suggested that the value on the rolls was not one-tenth of the true amount. The abolition of both the municipal personal property tax and the municipal income tax and concentration on the real property tax was recommended. Municipalities suspected that 80 to 90 percent of personal property was escaping taxation.<sup>6</sup> This dissatisfaction led to the establishment of further commissions to study taxation questions and ultimately, the replacement of the tax.

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<sup>5</sup> Perry (1955, 84-85).

<sup>6</sup> Perry (1955, 87).

### *The Shift to Real Property Taxation*

The Smith Committee provides the chronology of the several commissions appointed to look into the property assessment and taxation system up to the turn of the century, the most significant being the McLennan Commission, reporting in 1901 and 1902.<sup>7</sup> The McLennan Commission was appointed to put an end to the debate over the personal property tax and to recommend an alternative. The Commission recommended the taxation of individuals with reference to their income either directly or indirectly. However, the flat rate occupancy tax that was recommended was rejected by the Select Committee of the Legislature appointed to review the Commission report. The Committee recommended the graded business occupancy tax that formed the key part of the 1904 reforms. The *Assessment Act* was amended to abolish municipal personal property tax and a business tax was substituted, based on the value of the property occupied, with a variation in the percentage rate of the additional assessment taxed based on the type of business.<sup>8</sup> The “business occupancy tax” system continued until 1998; the rates varied from 140 percent for distilleries to 30 percent for small business and were not amended until 1989. Apparently, the new business assessment percentages were chosen to generate the same level of income as the previous personal property tax.

The *Assessment Act* of 1904 also dealt with municipal income taxation that had previously been a part of the personal property tax. Source reporting of salaries and wages was introduced and a definition of income which would form the basis of the subsequent definition adopted in the *Dominion War Tax Act* was adopted.<sup>9</sup> This form of taxation remained optional for the time being.

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<sup>7</sup> Ontario Committee on Taxation (1967, v.II, 41-42).

<sup>8</sup> Perry (1955, 587).

<sup>9</sup> Perry (1955 v.1, 133 and 157).

From the perspective of the real property assessment base, the exemption for machinery from real property assessment was introduced limiting property taxation to land and buildings.(This continues to this day). The provisions of the 1904 Act governed the assessment of property in the remainder of the period under study. The shift to exclusive reliance on real property tax was completed when the Province finally abolished municipal income tax in 1936 in response to federal pressure.

### ***Governance***

The essential features of the Ontario municipal system were established in 1849 by the *Municipal Corporation Act*, more familiarly known as the Baldwin Act by the Legislative Assembly of Canada West. The *Act* established the structure for local government that continues to prevail, including cities, towns, villages and townships and the county system. Counties and towns, villages and townships constituted a two-tier system of government. The county council was composed of the elected reeves and in some cases the elected deputy reeves of the supporting municipalities. Cities and separated towns (separated from the county) as single-tier governments<sup>10</sup> did not form part of the county government and were excluded from sharing in county costs that resulted from the responsibility for the administration of justice, roads and welfare within a county. Local municipalities were given the authority to levy property taxes while counties relied on requisitioning funds from their constituent lower-tier municipalities.

In 1850, the *Common Schools Act* provided the authority for the establishment of a tax-supported education system. Elected school trustees were given the right to require taxes to be levied on property for school support. The Act also placed the responsibility for the provision of

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<sup>10</sup> The term “local municipalities” is used to describe cities, towns, villages, townships and improvement districts (precursors to townships in northern Ontario).



funds to the school boards as well as solving the problems of tax collection on the municipal authorities in urban areas. In townships, the public school trustees had a choice between providing their own tax collectors or placing the onus upon municipal authorities to perform this function. In 1877, this choice was removed and the onus lay with the municipalities to collect and remit taxes in the public system.<sup>11</sup> By 1867, Ontario had a functional legal framework for local governance and finance—the jurisdiction of the provinces over local institutions was confirmed in the British North America Act (1867). Thus, the rules governing the “creatures of the Province” were in place and have continued since.

### *The Urbanization of the Province*

Between Confederation and 1886, nearly 700 municipal jurisdictions had been established in Ontario. This included 38 counties, 453 townships, 196 towns and villages and 11 cities. The eleven cities included Belleville, Brantford, Guelph, Hamilton, Kingston, London, Ottawa, St. Catharines, St. Thomas, Stratford and Toronto.

By the 1930s, over 900 municipal jurisdictions existed in Ontario, including separated cities and towns, as well as towns and townships that supported county governments. The number of cities, with populations over 10,000 had increased to twenty-seven, with the addition/elevation of Oshawa, Niagara Falls, Welland, Sudbury, Galt, Kitchener, Woodstock, Windsor, Owen Sound, Chatham, Sarnia, Peterborough, Sault Ste Marie, Fort William and Port Arthur to this level of municipal status. In 1921, 58.2 percent of Ontario's 2.9 million people lived in urban areas. By 1941, total population had expanded to nearly 3.8 million and the urban population was 61.7 percent of the total based on any urban community regardless of size.<sup>12</sup>

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<sup>11</sup> This would become significant in the 1930s. .

<sup>12</sup> Drummond (1987, 167 and 412), based on the 1941 census definition.

**Table 1. The Changing Distribution of the Population of Ontario**

|             | <b>Rural</b>   | <b>Urban</b> | <b>Total</b>   | <b>Rural</b> | <b>Urban</b> |
|-------------|----------------|--------------|----------------|--------------|--------------|
|             | <b>(‘000s)</b> |              | <b>(‘000s)</b> | <b>%</b>     |              |
| <b>1871</b> | 1,264.8        | 355.9        | 1,620.7        | 78.0         | 22.0         |
| <b>1881</b> | 1,351.1        | 575.8        | 1,926.9        | 70.1         | 29.9         |
| <b>1891</b> | 1,295.3        | 819.0        | 2,144.3        | 60.4         | 38.2         |
| <b>1901</b> | 1,246.9        | 936.0        | 2,182.9        | 57.1         | 42.9         |
| <b>1911</b> | 1,198.8        | 1,328.5      | 2,527.3        | 47.4         | 52.6         |
| <b>1921</b> | 1,227.0        | 1,706.6      | 2,933.6        | 41.8         | 58.2         |
| <b>1931</b> | 1,335.7        | 2,096.0      | 3,431.7        | 38.9         | 61.1         |
| <b>1941</b> | 1,449.0        | 2,338.6      | 3,787.6        | 38.3         | 61.7         |

Source: Census of Canada (1951 v.1, table 13).

The changing distribution of the population as shown by the decennial census (Table 1) is also broadly consistent with the pattern shown in Figure 1 based on population data drawn from aggregated assessment records.<sup>13</sup> In Figure 1, the rural category includes the population in townships while urban includes towns and villages. In 1872, over seventy percent of the assessed population was to be found in the rural townships, while twelve and fourteen percent of the assessed population lived in towns and cities, respectively. As Figure 1 (based on assessment records) shows, the shift in population to the cities continued steadily from the early 1880s to the early 1920s. There is a noticeable acceleration in the growth of city populations during the decade immediately before the First World War. The rural areas had less than half the provincial population after 1906. By 1941, 46.7 percent of the assessed population was tallied in the cities; 18.6 percent in towns and 34.7 percent in rural areas.

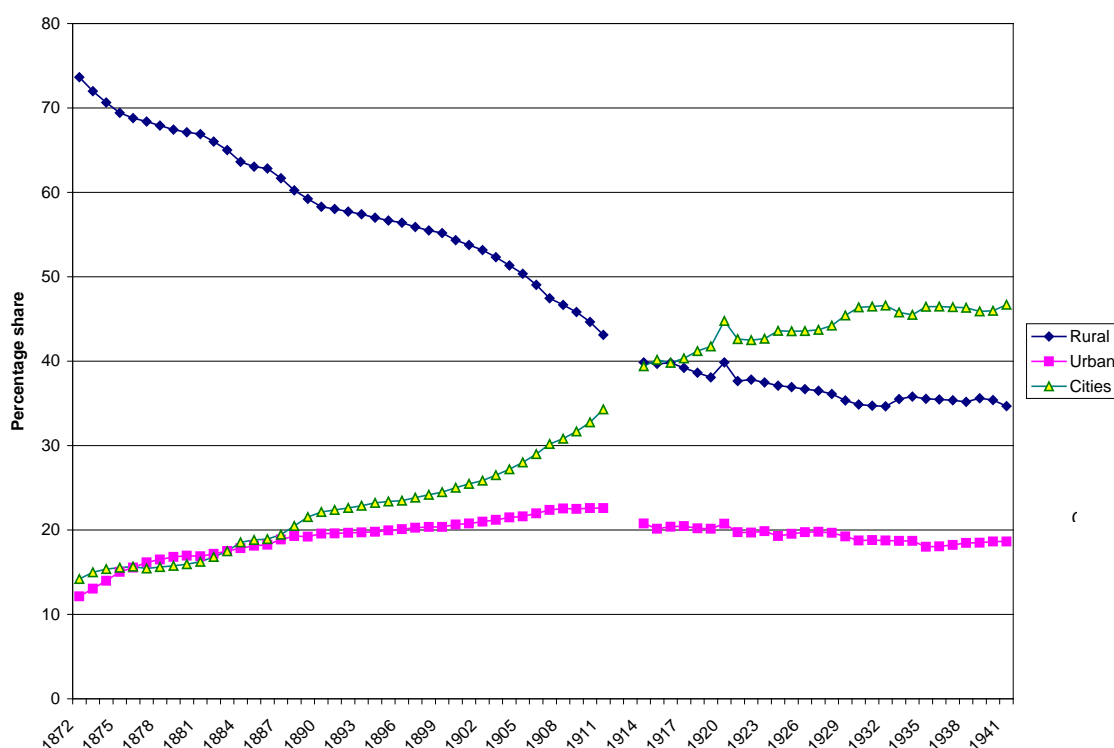
This population shift to the cities underlies a recent reassessment of the pattern of the development of the Canadian economy during the wheat boom era by McInnis (2007). McInnis argues that the impact of urbanization, the development of large-scale manufacturing, capital investments in electrical supply and the development of processed food exports are responsible for the exceptional average rate of per capita income growth from 1896 to 1907, (4.4 percent per

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<sup>13</sup> The Province reported assessed populations in the annual reports of the Ontario Bureau of Industries and in various departmental reports.

annum) compared to 2.3 percent from 1907 to 1913, not the classic story of the wheat boom and its multiplier effects.<sup>14</sup> As will be seen, the pattern of municipal expenditures, tax levels and indebtedness, with significant accelerations in all of these during the subsequent two decades appears to be a reaction to increasing demand for urban service improvements.<sup>15</sup>

**Figure 1. Population Distribution in Ontario**



Source: Author's Calculations based on data from the Annual Reports of the Ontario Bureau of Industries and the Department of Municipal Affairs.

From 1901 to 1941, the increase in population of individual cities is shown on Table 2. The most striking increases took place in the cities where either automobile manufacturing or mineral exploitation provided an economic base for urban growth. By 1941, 44 percent of the

<sup>14</sup> McInnis (2007, 6).

<sup>15</sup> Green and Sparks (1999, 63) conclude that population was the most significant driver of GNP in the post 1909 period as well.

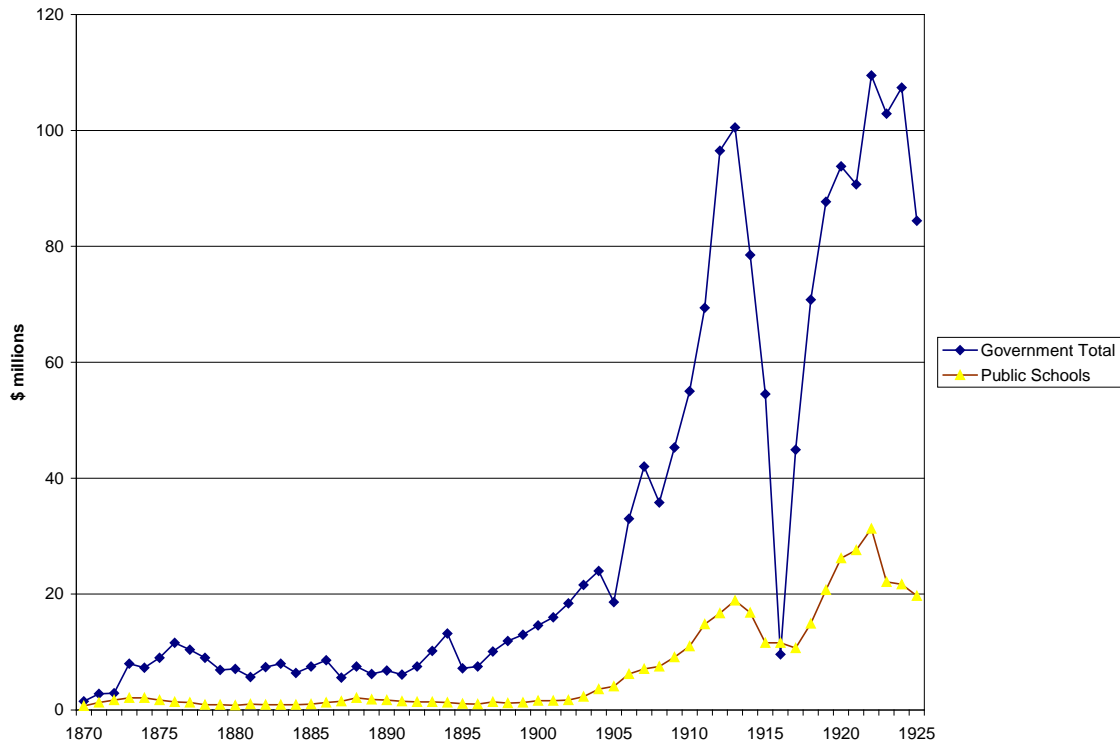
population was in these cities according to the Census. The demand for government investment in infrastructure consequent on urbanization is captured graphically in Figure 2 using Urquhart's (1993) estimate of government gross fixed capital formation.

**Table 2. Population of Ontario Cities, 1901-1941**

| <b>Municipality</b>    | <b>1901</b>    | <b>1911</b>    | <b>1921</b>      | <b>1931</b>      | <b>1941</b>      |
|------------------------|----------------|----------------|------------------|------------------|------------------|
| <b>Toronto</b>         | 208,040        | 376,471        | 521,893          | 631,207          | 667,457          |
| <b>Oshawa</b>          | 4,394          | 7,436          | 11,940           | 23,439           | 26,813           |
| <b>Hamilton</b>        | 52,634         | 81,969         | 114,151          | 155,547          | 166,337          |
| <b>Niagara Falls</b>   | 4,244          | 9,248          | 14,764           | 19,046           | 20,589           |
| <b>St Catharines</b>   | 9,946          | 12,484         | 19,881           | 24,753           | 30,275           |
| <b>Welland</b>         | 1,863          | 5,318          | 8,654            | 10,709           | 12,500           |
| <b>Ottawa</b>          | 59,928         | 87,062         | 107,843          | 126,872          | 154,951          |
| <b>Sudbury</b>         | 2,027          | 4,150          | 8,621            | 18,518           | 32,202           |
| <b>Galt</b>            | 7,866          | 10,299         | 13,216           | 14,005           | 15,346           |
| <b>Kitchener</b>       | 9,747          | 15,196         | 21,763           | 30,793           | 35,657           |
| <b>Woodstock</b>       | 8,833          | 9,320          | 9,935            | 11,395           | 12,461           |
| <b>Brantford</b>       | 16,619         | 23,132         | 29,440           | 30,107           | 31,948           |
| <b>St Thomas</b>       | 11,485         | 14,054         | 16,026           | 15,430           | 17,132           |
| <b>Windsor</b>         | 12,153         | 17,829         | 38,591           | 63,108           | 105,311          |
| <b>East Windsor</b>    |                |                | 5,870            | 14,251           |                  |
| <b>Kingston</b>        | 17,961         | 18,874         | 21,753           | 23,439           | 30,126           |
| <b>Owen Sound</b>      | 8,776          | 12,558         | 12,190           | 12,839           | 14,002           |
| <b>Belleville</b>      | 9,117          | 9,876          | 12,206           | 13,790           | 15,710           |
| <b>Chatham</b>         | 9,068          | 10,770         | 13,256           | 14,569           | 17,369           |
| <b>Sarnia</b>          | 8,176          | 9,947          | 14,877           | 18,191           | 18,734           |
| <b>London</b>          | 37,976         | 46,300         | 60,959           | 71,148           | 78,134           |
| <b>Stratford</b>       | 9,959          | 12,946         | 16,094           | 17,742           | 17,038           |
| <b>Peterborough</b>    | 11,239         | 18,360         | 20,994           | 22,327           | 25,350           |
| <b>Guelph</b>          | 11,496         | 15,175         | 18,128           | 21,073           | 23,273           |
| <b>Sault Ste Marie</b> | 7,169          | 10,984         | 21,092           | 23,083           | 25,794           |
| <b>North Bay</b>       | 2,530          | 7,737          | 10,692           | 15,528           | 15,599           |
| <b>Fort William</b>    | 3,633          | 16,499         | 20,541           | 26,277           | 30,585           |
| <b>Port Arthur</b>     | 3,214          | 11,220         | 14,886           | 19,818           | 24,426           |
| <b>Total</b>           | <b>550,093</b> | <b>875,214</b> | <b>1,200,256</b> | <b>1,489,004</b> | <b>1,665,119</b> |
| <b>Ontario</b>         | 2,182,947      | 2,527,292      | 2,933,662        | 3,431,683        | 3,787,655        |
| <b>City Share (%)</b>  | 25.2           | 34.6           | 40.9             | 43.4             | 44.0             |

Source: Census of Canada (1951 v.1, table 13) and Author's calculations.

**Figure 2. Gross Government Fixed Capital Formation (Current Dollars)**



Source: Urquhart (1993, 16-17).

While Urquhart's estimate of government gross fixed capital formation was constructed on a nation-wide basis, it is striking and not surprising that the pattern shown on Figure 2 is similar to the pattern shown in many of the figures that follow in the rest of this study. In particular, the pattern of accelerated growth after the turn of the century, volatility during the war and the post-war period will reappear in the figures below of local expenditures, taxes and indebtedness.

## ***2.4 The Intergovernmental Fiscal Context***

### ***2.4.1 Different Tax Bases at the Different Levels of Government***

At Confederation, municipal tax effort in Ontario represented a significant share of the public finances of the nation. At this point in time, the “creatures” were bigger in aggregate in fiscal terms than the Province, their senior level of government. Relative to municipal tax effort in the new Dominion generally and in respect to the newly established federal government, Perry notes:

“One of the earliest published official statistical returns for municipalities in Ontario shows that in 1867 total tax revenues amounted to \$3.2 million, representing the yield of taxes imposed on real estate assessed at \$213 million, personal property assessed at about \$24 million, and taxable incomes of \$7.7 million. In the following year total revenues of the new national government, to give a basis of comparison, were only \$13.7 million. It is also interesting that in the Budget Speech of 1868 John Rose estimated that total municipal taxation in the new Dominion was \$4.7 million, which suggests that all but \$1.5 million of the total was levied in Ontario.”<sup>16</sup>

Tax assignment in this period was relatively straight-forward. Perry makes the point that: “the allocation of taxes agreed upon in 1867 was that the provinces were to have the unpopular direct taxes and certain licences, while the Dominion was to be without let or hindrance in its taxing rights.”<sup>17</sup> Citing remarks attributed to Alexander Galt, the pre-Confederation Minister of Finance of the Province of Canada, it is clear that there was an expectation that the unpopularity of direct taxes would serve as a check on provincial extravagance- the beginning of the ability-to-pay versus benefits received debate in Canada as well as the limits on profligacy at the sub-national government level imposed by dependence on direct (property) taxes. These remarks are

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<sup>16</sup> Perry (1955, 34).

<sup>17</sup> Perry (1955, 46). The provinces were limited to “direct taxation within the Province in order to the raising of a revenue for Provincial purposes” (s.92(2)), and to “Shop, saloon, tavern, auctioneer and other licences in order to the raising of a revenue for Provincial, local or municipal purposes” (s.92(9)). The Dominion was given unlimited power for “the raising of money by any mode or system of Taxation” (s.91(3)).

quoted verbatim in the Ontario submission to the Rowell-Sirois Commission as part of an argument over the appropriateness of the assignment and sharing of the income and corporate tax bases. Another motivation for the tax assignment enshrined in the *British North America Act* may have been that “the provinces in which direct taxes had already been imposed at Confederation (particularly Upper Canada) needed the right, if for no other reason than to authorize their municipalities to continue to impose property taxes.”<sup>18</sup> Had this right been extinguished, there would have been no local capacity to meet contractual financial obligations that continued through this period of institutional change. Unpopularity, however, did not stop an increase in the effective rates of property taxation over time as municipalities grew into the tax capacity of the base and faced the challenges of financing expensive services.

Wallis (2001) puts the benefit view at the centre of his argument for the initial assignment of the property tax to local finance and its subsequent longevity in the U.S. He argues that “the ability to more closely match the beneficiaries of government investments, policies and programs with the taxpayers who foot the bill creates a distinct advantage for the property tax at the local level.”<sup>19</sup> In particular, as local roads and local education were the largest expenditure items, local voters could readily discern the benefits received.

Taking this argument further, Wallis and Weingast (2005) pose the question as to why state and local governments were predominant in spending on infrastructure during the nineteenth century in the United States. They point out that the U.S. Constitution requires that federal direct taxes be apportioned to states on the basis of population in contrast to a political or constitutional constraint. Thus states could use benefit taxes (property taxes) to specifically link project finance to the expected gain in property value and did so while the federal government

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<sup>18</sup> Perry (1955, 47).

<sup>19</sup> Wallis (2001, 145).

was precluded from making this link. This in turn kept the federal government small relative to the states until the dictates of war finance and economic events in the twentieth century shifted the use of tax instruments.

Sokoloff and Zolt (2005) argue that the property tax was a progressive tax during the nineteenth century in both the northern United States and Canada by contrast to excise taxes, the principal other source of government revenue. In their view, there is a strong link between the growth of local institutions including universal public schooling and the provision of local infrastructure and access to a “progressive” tax.<sup>20</sup> They characterize this public funding of decentralized services as providing a “broad distribution of social returns.”

A consequence of the urbanization of Canadian population that took place at the turn of the nineteenth century was the relatively large place occupied by the national aggregate of the municipal sector’s revenues in the intergovernmental distribution of the total revenues of governments.

“By 1913 municipal revenues were two and one-half times provincial revenues and only 20 percent less than those of the Dominion. This trend was to continue until, just prior to the depression of the thirties, municipal revenues actually exceeded Dominion revenues and were almost double provincial revenues, having increased from \$110 million in 1913 to \$317 million.”<sup>21</sup>

As Perry notes: “it was not until nearly the end of the century that the provinces made any show of using their powers by levying taxes on corporations and successions.”<sup>22</sup> The following table provides a comparison of the estimated relative fiscal effort of the three levels of government in Ontario during this period. Municipalities were dependent on property taxation, the provincial revenues came largely from succession duties and corporate taxation until the

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<sup>20</sup> Sokoloff and Zolt (2005, 27-28).

<sup>21</sup> Perry (1955, 124).

<sup>22</sup> Perry (1955, 48).



latter part of the 1930s while the federal government relied on customs and excise duties until the end of the First World War.

**Table 3. Taxation in Ontario**

|             | <b>Local</b>     | <b>Net</b>        | <b>Total</b>     | <b>Estimate</b>   |
|-------------|------------------|-------------------|------------------|-------------------|
|             | <b>Tax</b>       | <b>Provincial</b> | <b>Federal</b>   | <b>Of Ontario</b> |
|             | <b>Imposed</b>   | <b>Revenue</b>    | <b>Revenue</b>   | <b>Share</b>      |
|             | <b>\$ M</b>      | <b>\$ M</b>       | <b>\$M</b>       | <b>\$M</b>        |
|             | <b>(Current)</b> | <b>(Current)</b>  | <b>(Current)</b> | <b>(Current)</b>  |
| <b>1886</b> | 9.0              | 1.4               | 36.0             | 14.5              |
| <b>1891</b> | 11.8             | 1.9               | 37.0             | 14.9              |
| <b>1896</b> | 12.1             | 1.9               | 38.0             | 15.4              |
| <b>1901</b> | 13.3             | 3.1               | 58.0             | 23.4              |
| <b>1906</b> | 18.0             | 5.7               | 68.0             | 27.5              |
| <b>1911</b> | 26.4             | 7.1               | 136.0            | 54.9              |
| <b>1916</b> | 48.3             | 11.2              | 233.0            | 94.1              |
| <b>1921</b> | 83.0             | 33.5              | 395.0            | 159.6             |
| <b>1926</b> | 102.1            | 51.2              | 401.0            | 162.0             |
| <b>1931</b> | 128.7            | 74.7              | 335.0            | 143.4             |
| <b>1936</b> | 117.9            | 82.7              | 454.0            | 204.3             |
| <b>1941</b> | 112.5            | 94.0              | 1489.0           | 670.1             |

Source: See text, Drummond (1987), Gillespie (1991) and Ontario (1938). Provincial revenues are net of transfers from the federal government. The estimate of Ontario's share is based on the tax collection efforts as estimated in Ontario (1938, table 3.)

Table 3 also shows that in terms of taxation, municipalities in aggregate exceeded the provincial tax effort in Ontario until the 1940s. Federal revenue efforts were significantly impacted by the two wars.<sup>23</sup> In general, the Ontario numbers suggest that while property taxes were increased to meet the needs of local governments - the urbanization of the economy was also placing more pressure on the Province to expand its revenues to meet increased pressure to spend on its areas of responsibility including roads, health care, social assistance and higher education. The table also shows the nominal decline in property taxes (measured in current dollars) occasioned by the shock of the Great Depression.

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<sup>23</sup> This pattern is very similar to the pattern of tax distribution in the US shown in Wallis (2001).

## ***2.5 Fiscal Framework of Local Government***

This section of the paper analyzes the trends in expenditures, revenues and debt of local governments in some detail. Both functional and structural aspects of expenditures are addressed. However, the expenditure numbers as published by the Province omit county and small rural expenditures in some years. The tax and debt numbers are more complete and are a better indicator of the extent to which structure and urban size influenced the relative shares and levels of taxing and spending.

### ***2.5.1 Expenditures***

In general, the broad categories used to report municipal expenditures reflect the responsibilities of local governments, whether mandated by the provincial government or demanded by the local voters. As such, the role of service provision and the types of service defined rather generically remained unchanged over the period.

In the late 1860s, the published aggregates show expenditures by municipalities on municipal services, excluding debt charges at just under \$3.5 million in current dollars and expenditures to meet school board requisitions of approximately \$600,000. These early numbers on education spending as recorded by municipalities seem questionable. The Department of Education shows education taxes between \$1.2 million and \$1.5 million from municipal sources between 1867 and 1871. By the late 1880s, the provincial data compiled from municipal records shows municipal expenditures had increased to over \$10.5 million for municipal services and around \$4.2 million for education purposes, compared to the departmental data of about \$3.9 million in local taxes. This level of expenditure prevailed in current dollar terms until around the turn of the century.

Before 1900, of total expenditures, just over 55 percent of the expenditures on municipal purposes and 25 percent of the expenditures for school purposes were made by cities.<sup>24</sup> The cities' share of municipal expenditure was close to double that of their population share before the turn of the century. More complex services were already being provided in cities than in the rural areas of the province. In terms of 1900 purchasing power,<sup>25</sup> total municipal expenditures increase from \$6.0 million in 1886 to around \$11.3 million at the turn of the century at an average annual rate of 4.6 percent to 1900. In real terms, expenditures on schools increase from approximately \$3.0 million to \$4.6 million or at an annual average rate of 3.4 percent over the same period and debt charges, (including both principal and interest) in real terms increase from \$2.2 million to nearly \$5.0 million at an average annual rate of 6.3 percent, as shown on Figure 4.

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<sup>24</sup> In this study, cities refers to municipalities having the legal status of city. These are the municipalities listed on Table 2, having a population greater than 10,000 by 1941. Towns and villages constitute the urban portion and townships the rural share of the population.

<sup>25</sup> Throughout this study, a price index constructed using the index recently constructed by Minns and MacKinnon (2007) and extended using Emery and Levitt (2002) has been used in the calculation of constant dollar data.

**Table 4. Average Municipal and City Expenditures, 1888-1933**

|                | Average Municipal Expenditures |        |         |       | Average City Expenditures |        |         |       |
|----------------|--------------------------------|--------|---------|-------|---------------------------|--------|---------|-------|
|                | Current Dollars                |        |         |       | Current Dollars           |        |         |       |
|                | Municipal                      | School | Debt    | Total | Municipal                 | School | Debt    | Total |
|                |                                |        | Charges |       |                           |        | Charges |       |
|                | \$M                            | \$M    | \$M     | \$M   | \$M                       | \$M    | \$M     | \$M   |
| <b>1888-98</b> | 10.0                           | 4.3    | 5.2     | 19.5  | 5.0                       | 1.1    | 3.1     | 9.3   |
| <b>1901-10</b> | 18.4                           | 6.9    | 6.4     | 31.7  | 10.2                      | 2.4    | 3.8     | 16.4  |
| <b>1924-33</b> | 75.7                           | 41.1   | 25.9    | 142.7 | 36.3                      | 20.8   | 13.3    | 70.4  |
| <b>1939-41</b> | 53.8                           | 30.8   | 33.3    | 117.9 | 43.5                      | 24.3   | 28.8    | 96.6  |
|                | Average Municipal Expenditures |        |         |       | Average City Expenditures |        |         |       |
|                | \$1900 Purchasing Power        |        |         |       | \$1900 Purchasing Power   |        |         |       |
|                | Municipal                      | School | Debt    | Total | Municipal                 | School | Debt    | Total |
|                |                                |        | Charges |       |                           |        | Charges |       |
|                | \$M                            | \$M    | \$M     | \$M   | \$M                       | \$M    | \$M     | \$M   |
| <b>1888-98</b> | 9.2                            | 3.9    | 4.7     | 17.8  | 4.7                       | 1.0    | 3.0     | 8.7   |
| <b>1901-10</b> | 15.9                           | 5.9    | 5.5     | 27.4  | 8.8                       | 2.1    | 3.3     | 14.1  |
| <b>1924-33</b> | 37.2                           | 20.1   | 12.7    | 70.1  | 17.5                      | 10.0   | 6.3     | 33.8  |
| <b>1939-41</b> | 26.5                           | 15.1   | 16.3    | 57.9  | 21.4                      | 11.9   | 14.2    | 47.5  |

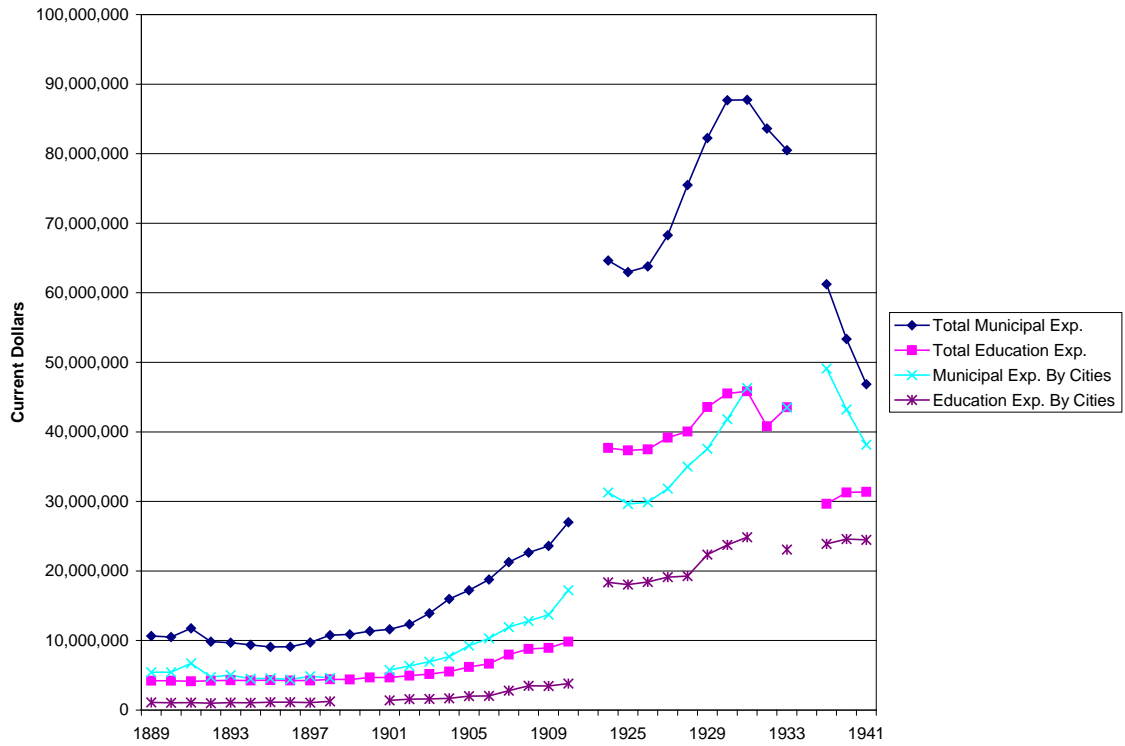
Source: Author's calculations and Annual Reports of the Ontario Bureau of Industries and the Department of Municipal Affairs.

From 1902, there is an apparent acceleration in city expenditures with a consequent increase in this category's share of the total expenditure. By 1910, cities in aggregate were spending over \$17 million in current dollars on municipal services and nearly \$4.0 million on education. (Figure 3) In real terms, city expenditures on municipal services more than doubled from \$5.6 million in 1901 to \$13.4 million in 1910. School expenditures also doubled in real terms and debt charges had increased by just under 25 percent. The city share had risen to over 80 percent of the municipal aggregate spending and the share of education spending had increased to nearly 40 percent. By 1924, city spending had increased by a third in nominal terms on municipal services and nearly fivefold for education. However, in real terms, it was only by

1929 that city spending on municipal services was above the real level reached in 1910. By contrast, in real terms, the school requisition and spending on debt charges significantly increased during the 1920s. These real increases suggest that during the 1920s, municipalities had to increase revenues in real terms to meet a perceived need to meet operating and capital costs for schooling and to fund the mandatory repayment of debts incurred to finance the infrastructure supporting urbanization.

During the 1930s, municipal spending levels increased, driven by the pressure to provide relief; spending on schools increased in current dollar terms but fell in real terms during the latter part of the decade. However, the city share in aggregated municipal expenditures fell during the 1920s and then increased to over 80 percent of total municipal expenditure suggesting that spending in rural and smaller urban centres did not keep pace with the growth in expenditures in the cities. The city share of total municipal debt charges (principal and interest) averaged 59 percent from 1889 to 1910; this share had increased to an average of 86 percent for 1939-1941.

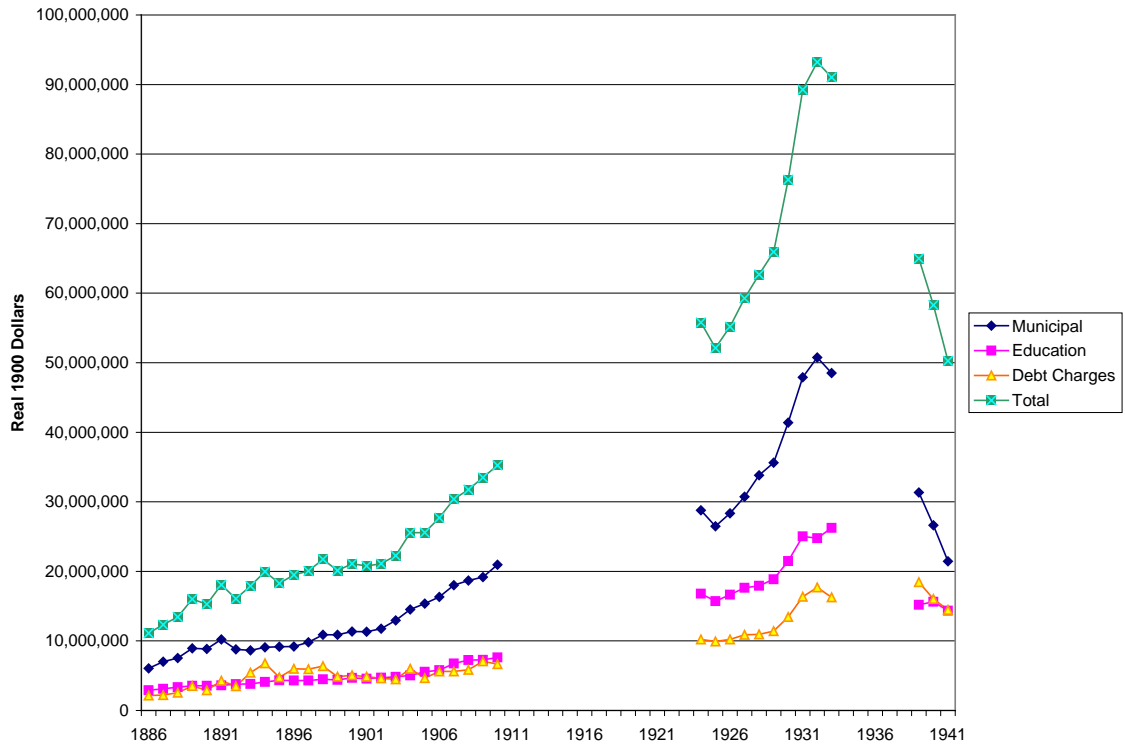
**Figure 3. Municipal Expenditures, 1889-1941 (Current Dollars)**



Source: Annual Reports of the Ontario Bureau of Industries and the Department of Municipal Affairs.

In real terms, municipal expenditures, split into broad spending categories increase to 1932 and then decline. This is shown in the next figure. In the later years of the 1930s, real debt service costs exceed the municipal contribution to education.

**Figure 4. Real Municipal Expenditures, 1886-1941 (\$1900s)**

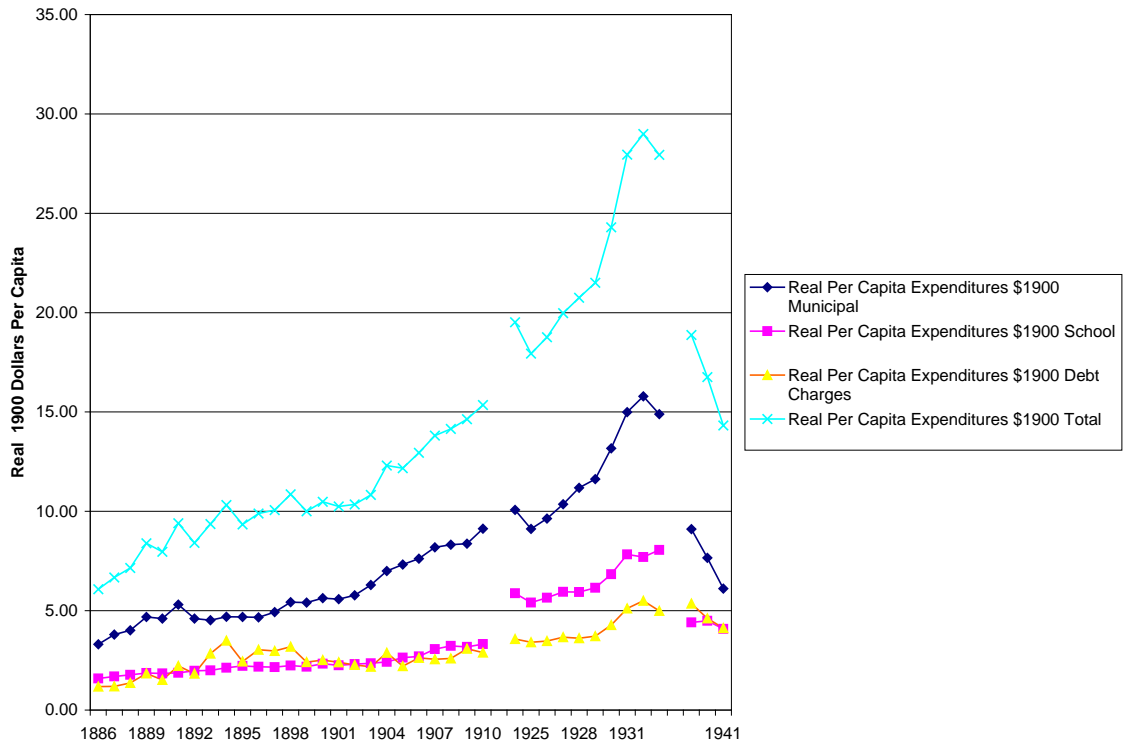


Source: Author's Calculations. Annual Reports of the Ontario Bureau of Industries and the Department of Municipal Affairs.

The pattern of real per capita municipal expenditure (Figure 5) mimics the aggregate total given the relatively slow increase in total population compared to municipal expenditures on traditional services, education and debt charges in the years for which data is available. The total expenditure increases from \$10 per capita in 1900 to \$15 by 1910. By 1924, total expenditures had reached nearly \$20 per capita (in 1900 dollars). The peak is reached at nearly \$30 in 1932 and falls to close to \$14 by 1941- reflecting deflation and reduced pressure on municipalities to spend on relief and debt charges as a result of a combination of factors including provincial

assistance and municipal reductions in borrowing. School expenditures per capita move from \$3 in 1910 to just over \$8 in real terms by 1933 and then decline to just over \$4 by 1941.

**Figure 5. Real Per Capita Municipal Expenditures, 1886-1941 (\$1900s)**



Source: Author’s Calculations and Annual Reports of the Ontario Bureau of Industries and the Department of Municipal Affairs.

Table 5 shows the changing distribution of the aggregated City expenditures among three categories: municipal, school and debt charges using the arithmetic means of the percentage shares. The column labelled Mandatory represents the total of the percentage shares of school and debt charges, relative to the total of city spending. Municipalities, in general, were required to make school contributions and attempted to avoid defaulting on debt. As such, this number provides a rough measure of the changing capacity for discretion, although understated by the extent of compulsory cost-sharing of expenditures on relief during the 1930s.



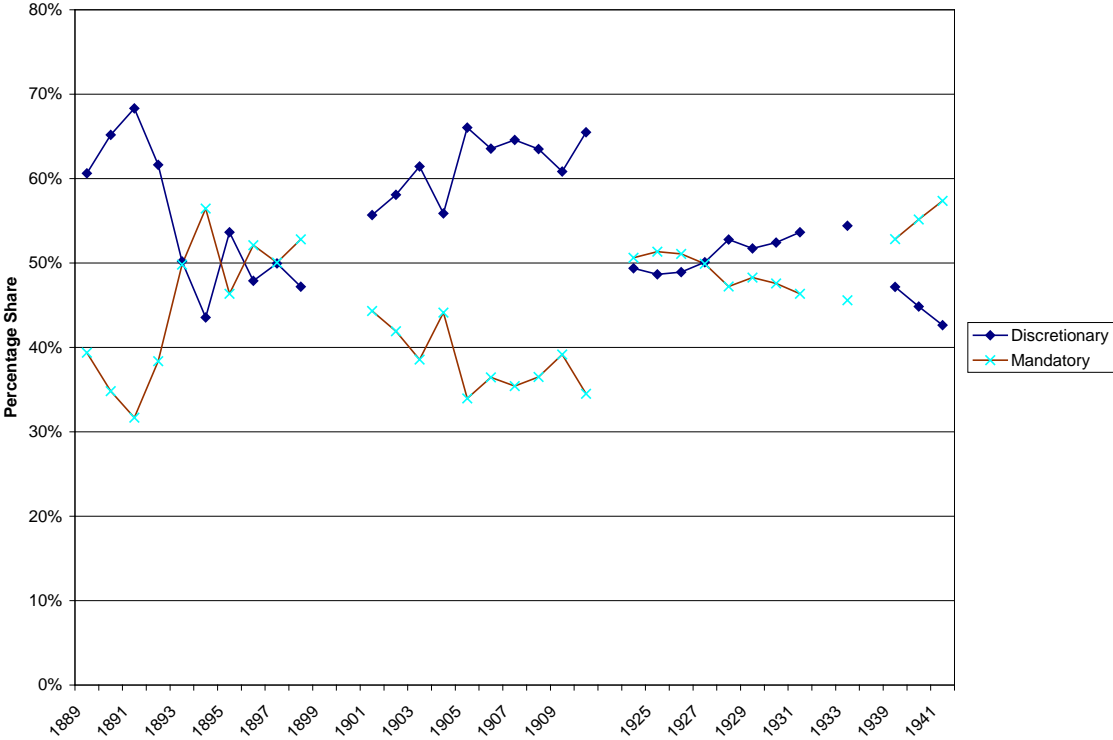
**Table 5. Average Percentage Share of City Expenditures**

|                  | <b>Municipal</b> | <b>School</b> | <b>Debt Charges</b> | <b>Mandatory</b> |
|------------------|------------------|---------------|---------------------|------------------|
|                  | <b>(1)</b>       | <b>(2)</b>    | <b>(3)</b>          | <b>(2)+(3)</b>   |
|                  | <b>%</b>         | <b>%</b>      | <b>%</b>            | <b>%</b>         |
| <b>1889-1898</b> | 57.9             | 11.1          | 31.0                | 42.1             |
| <b>1901-1910</b> | 61.5             | 14.4          | 24.1                | 38.5             |
| <b>1924-1933</b> | 51.3             | 29.6          | 19.1                | 48.7             |
| <b>1939-1941</b> | 44.9             | 25.3          | 29.8                | 55.1             |

Source: Author's Calculations. Calculations and Annual Reports of the Ontario Bureau of Industries and the Department of Municipal Affairs.

While the choice of time periods represents data constraints, several conclusions may be drawn from Table 5. The larger urban centres of the province were able to increase discretionary spending on municipal services at least until 1910. During the 1920s and the 1930s, their level of discretion was seemingly reduced as education's share doubled, although offset somewhat to 1933 by a decline in the share of debt service. By 1939, the increased share of debt service more than offset the decline in education share, resulting in a significant narrowing of municipal flexibility. To the extent that expenditures on relief programs after 1933 are not reflected in the mandatory share of expenditures, the extent of municipal discretion shown is understated.

**Figure 6. Ontario City Expenditures, 1889-1941: Discretionary vs. Mandatory**



Source: Author’s calculations and Annual Reports of the Ontario Bureau of Industries and the Department of Municipal Affairs.

Turning to an analysis of the changes in the share of expenditures of the functional categories, based on data published by the Province, detailed data has been compiled for all municipalities for the period from 1889 to 1910 and for 1939 to 1941. Data has also been compiled for cities from 1889 to 1910; 1924 to 1933; and 1939 to 1941.<sup>26</sup>

<sup>26</sup>The categories follow current convention.

**Table 6. Functional Share of Municipal Expenditures**

|                  | 1888-1898 |        | 1901-1910 |        | 1924-33 | 1939-41 |        |
|------------------|-----------|--------|-----------|--------|---------|---------|--------|
|                  | All       | Cities | All       | Cities | Cities  | All     | Cities |
|                  | %         | %      | %         | %      | %       | %       | %      |
| <b>Gen.Govt.</b> | 13.2      | 7.9    | 12.5      | 10.4   | 9.8     | 11.4    | 10.6   |
| <b>Protect.</b>  | 22.9      | 29.4   | 21.1      | 25.8   | 28.2    | 23.5    | 25.1   |
| <b>Health</b>    |           |        |           |        | 12.4    | 9.8     | 10.2   |
| <b>Roads</b>     | 31.0      | 31.3   | 32.9      | 31.4   | 15.0    | 10.1    | 8.3    |
| <b>Utilities</b> | 17.7      | 18.2   | 21.7      | 21.3   |         |         |        |
| <b>Charities</b> | 3.6       | 4.6    | 4.8       | 5.2    | 15.0    | 7.8     | 8.8    |
| <b>Relief</b>    |           |        |           |        |         | 22.0    | 21.2   |
| <b>Rec.</b>      |           |        |           |        | 6.5     | 5.9     | 6.6    |
| <b>Misc.</b>     | 11.6      | 8.6    | 7.0       | 5.9    | 13.1    | 9.5     | 9.2    |
| <b>School</b>    | 29.9      | 18.0   | 27.2      | 18.9   | 36.6    | 36.7    | 36.0   |

Source: Author’s Calculations and Annual Reports of the Ontario Bureau of Industries and the Department of Municipal Affairs.

Table 6 provides the percentage shares of the various functions in the composition of local expenditures averaged over the time periods for which data is available. The municipal shares add to one hundred. The school share is the share of total local expenditures on education as reported by municipalities. Assuming that there is some consistency over time in the reporting conventions used to originally assign the data at the municipal level, there is a noteworthy stability in the percentage shares of the categories of expenditure in the municipal total. For example, spending on “General Government,” (sometimes known as “the sinkhole of municipal accounts”) averaged 13 percent of total municipal expenditures on municipal services from 1889 to 1910 and 11.4 percent from 1939 to 1941. This category reflects the costs of administration.

By consolidating expenditures on street lighting, water supply and fire protection with other expenditures on policing and prisons, a reasonably consistent category of “Protection to Persons and Property” is obtained. Spending in this category accounted for an average of 22.1

percent of municipal expenditures from 1889 to 1910 and an average of 23.5 percent from 1939 to 1941.

The spending share of “Charities, Hospitals and the Board of Health” generally grew from 3 percent to 5 percent in the period prior to the Great War. By the beginning of the 1940s, this category had increased to over 8 percent of municipal spending. This is consistent with the slow expansion of municipal services in public health and in various social assistance initiatives prior to the Great Depression. From 1924 to 1931, this spending category, on average accounted for 13.6 percent of municipal spending. However, in 1933, the number jumped to 26.5 percent reflecting the inclusion of relief expenditures in this category in the published data. By 1939, disaggregation of the spending category shows that the spending on charities averaged around 9 percent at the close of the 1930s while expenditures on relief reached over 30 percent of the municipal total in 1939 and then fell.<sup>27</sup>

In the “Highways, Roads and Streets” category, there is consistency in the sub-periods, which suggests consistency in accounting but does pose some interpretative issues. From 1886 to 1910, expenditures on roads and bridges averaged 32 percent of municipal expenditures and this share fell to 10 percent on average by the beginning of the 1940s. In the cities, the data shows that during the mid-twenties and early 1930s the average share of expenditures on roads was about 15 percent suggesting that other spending pressures were taking priority. Contemporary opinion did not neglect the implications of accommodating the automobile. Argument linking infrastructure expenditure and a desire for revenue diversification was a theme of the Ontario Association of Real Estate Board’s effort to lobby for a municipal share of taxes on gasoline and licence fees:

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<sup>27</sup> For more detailed analysis, see Struthers (1983) and (1991) and Tassonyi (1994) and Tassonyi(2011).

Not only have tremendous sums been spent by urban municipalities but the urge and necessity for further expenditures is self-evident. If we are to cut down the frightful casualty list in our cities- if we are to conserve commercial property values by solving the parking problem-if we are to furnish and repair asphalt pavements, widen our streets, round off our corners, provide overhead traffic control signals and cost of traffic policemen, find parking areas and supply signs for them, bear part of the tremendous cost of litigation brought about by accidents, then the funds for these purposes should come from the automobile and not from real estate.<sup>28</sup>

This theme was also noted in the Rowell-Sirois report. As both levels of government integrated local roads into a highway network, density in urban form was reduced with consequent fiscal impact:

“the automobile promoted the growth of suburban areas around the large cities, thus extending the areas which required new community equipment and various municipal services. The rapid increase in the use of the automobile throughout the twenties made suburban development, as well as highway construction and maintenance, an ever heavier burden.”<sup>29</sup>

The Dominion-Provincial Conference on Reconstruction also compiled statistics pertaining to the level and composition of the expenditures of Ontario municipalities covering the period from 1933 to 1943.<sup>30</sup> The categories of expenditure used in this compilation vary somewhat from the categories used in the Provincial government’s publications. Again, stability in functional shares over time is the key finding.

As another example of exogenous technological pressure, investment in water supply and sanitary sewerage infrastructure also had an impact on municipal spending. With respect to sanitation, Steele notes that “impressionistic evidence suggests that few dwellings had such

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<sup>28</sup> Ontario Association of Real Estate Boards (1937, 20).

<sup>29</sup> RCDPR( 1940 v. 1, 129). Goldenberg (1939) in the background study noted that: “the growth of urban areas has been in large part of a dispersive character; the paved road and the motor car encourage the development of far-flung “dormitory” suburbs, whose increasing population require more and better roads. Expenditure even on municipal streets is much more expensive by reason of the superior road- surface now required, the widening of existing streets for the creation of arterial roads, and so forth.”

<sup>30</sup> Dominion- Provincial Conference on Reconstruction (1945 148-152).

conveniences in 1891 and a substantial number had them in 1901” (referring to flush toilets). “Then in the 1890s and 1900s municipal sewage systems were installed and building regulations relating to plumbing and to fire residence were tightened.”<sup>31</sup> The Coats report suggests that higher rents are attributed in part to higher standards of construction required by more stringent building by-laws. There was also a general demand for conveniences which a few years ago were luxuries.

One may infer from reports on local conditions in 1913 that sewage systems and tougher bylaws were established before 1900 in the larger cities, especially in central Canada. We make this inference because no reference is made to the recent installation of such facilities in the case of larger places, while there are frequent such references in the case of smaller places. .For Brantford, “... sanitary conveniences are now more general”. For Guelph, because of a “new” building by-law, “there has been a tendency for the labouring classes to move to outlying portions of the city and to build cheap houses without sanitary conveniences”<sup>32</sup>

In Toronto, the pre-World War I annexation of smaller communities posed similar issues. Harris (1996) describes the situation in the Village of North Toronto where sewers had been installed in 1910-11. The system had been designed to handle thirty gallons per person but by 1913, the per capita load was three times the design capacity. Moreover, it was discovered that some pipes ran uphill. (Sewers are normally designed to take advantage of gravity.) The local tax rate was increased from 19.25 mills to 30.5 mills to accommodate the costs of rectifying the deficiencies.<sup>33</sup>

The pressure to invest in municipal capital infrastructure paralleled the experience in the rapidly urbanizing areas of the United States as well. Cain and Rotella (2006) document the spread of spending on sewer capital in American cities during this period and suggest that the

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<sup>31</sup> Steele (1993, 534). See Harris (1996, 155-156) for a description of the Toronto experience.

<sup>32</sup> Board of Enquiry into the Cost of Living, (1915, v.II, 385) as cited in Steele (1993, 547) Unregulated land use may have acted as an incentive to sprawl. See Harris (1996).

<sup>33</sup> Harris (1996, 151-2).

implementation of major spending projects on water quality and sanitation was assisted by improved circulation of engineering information. There was a demand for action to reduce mortality in cities.<sup>34</sup> Cutler and Miller (2006) argue that municipalities were the level of government with legal and financial capacity required to make the major investments made in municipal water supply systems in the United States during this period which resulted in a significant increase in municipal indebtedness as well.<sup>35</sup>

### **2.5.2 Revenues**

The legal framework for municipal revenues provides a constraint on the ability of municipalities to drastically alter the composition of their revenue base; however, this framework provided long-run stability and simplifies the task involved in time series comparisons. Kitchen notes:

In fiscal year 1878-79, 81 percent of Toronto's tax revenues came from taxes on real estate, 15 percent from taxes on personal property, and 4 percent from taxes on income-figures that provide some indication of the breakdown for Ontario municipalities in general. In fiscal year 1892-93, the Toronto figures were, respectively, 89 percent, 7 percent and 4 percent.<sup>36</sup>

In order to obtain reasonably comparable numbers over time, the revenue data from provincially published source documents were aggregated in the construction of the data base for this chapter to reflect more current reporting conventions. The overwhelming reliance on property taxation is apparent from the beginning.

In reporting the taxation data, there is a distinction between "Taxes Imposed" or levied and "Taxes and Rates Received." The former reflects the taxing intentions of municipalities on

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<sup>34</sup> See Cain and Hong (2009) and Troesken (2001).

<sup>35</sup> Cutler and Miller (2006, 174).

<sup>36</sup> Kitchen (2002, 13) based on Perry (1955, 85).

an annual basis at the time the taxing by-law was adopted while the latter reflects the collection efforts for both local taxation and county “rates.” As such, the latter reflects the actual amounts collected and may include adjustments due to rebates (for errors), write-offs, pre-levies, additions to the roll through the supplementary or omitted assessment process as well as the collection of arrears.

From 1886 to 1910, taxes and rates received (for county purposes), averaged 85.4 percent of own- source revenues. For the period 1924 to 1933, taxes averaged 83.4 percent of own- source revenues.<sup>37</sup> During the period, 1913-1937, according to the Rowell-Sirois Commission, the principal revenue sources for Ontario municipalities were real property taxes, business taxes, and provincial transfers.<sup>38</sup> Taxes on real property varied around 77 to 79 percent of total revenues. Provincial grants were increased from 2.7 percent of total revenues in 1913 to 7.6 percent by 1937, reflecting increases in both conditional and unconditional transfers. Other own- source revenues included fee revenues from licenses and permits and the transfer of surplus revenues from the operation of public utilities. These amounted generally to less than 10 percent of total revenue except in 1913. A more nuanced discussion of the trends in the growth of revenues follows the description of the growth in the underlying assessment base.

### ***2.5.3 Assessment Base***

At the beginning of the period under scrutiny, the principal components of the assessment base upon which local taxes were levied included real property, both land and buildings, personal property and income. In 1904, personal property assessments were replaced with business

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<sup>37</sup> Calculated from the annual reports of the Ontario Bureau of Industries and the Department of Municipal Affairs.

<sup>38</sup> The Commission published the first consistent historical comparisons of revenue and expenditures using data from provincial submissions and made some adjustments. The tax revenue totals for the years shown in the Commission tables are consistent (and based on the same source) with the aggregate data used in the discussion of patterns and trends that follows.



assessment. The same mill rate was applied to each assessment dollar. To the extent that values were not updated consistently, these numbers underestimate the true market value of land and buildings in current dollars.<sup>39</sup> As noted, the assessment of personal property was also subject to significant evasion, (at least in the views of contemporaries). Despite these defects, the numbers do however illustrate changing trends in the potential fiscal capacity of local governments during the period.

As may be expected the periodic changes in trends in terms of increase and decrease in the assessment base parallel the trends in the Ontario economy. In current dollars, from 1886 to the turn of the century, real property assessment grew from approximately \$650 million to \$800 million and then to \$2 billion by 1914. However, in terms of 1900 purchasing power, the base grew from \$530 million in 1886 to \$800 million in 1900 and increased to approximately \$1.5 billion during the decades before World War I, (Figure 7). During the war and its immediate aftermath, the current value of the base increased slightly; in real terms, there is a measured decline from 1917 to 1920. The peak in both current and real values is reached in 1932. Similarly, in nominal terms, business assessments triple from their inception in 1904 to the end of the Great War; in real terms, an increase of about 25 percent over the period. During the 1920s, there is some growth annually reaching a peak in 1932, followed by a decline to 1941. This is also evident on the charts showing the trends in the various assessment bases in both current and constant dollars. The trough after the Great War in constant dollar terms is particularly evident relative to the continuous impact of inflation on values in the current dollar series.<sup>40</sup>

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<sup>39</sup> For a discussion of assessment practice and purposeful undervaluation, see Harris (1996, 290-292) particularly during the war years.

<sup>40</sup> The trends in assessment are also consistent with other data. These comments from Steele (1993, 569) relate to the data she used to estimate the housing component of Urquhart's estimates

#### ***2.5.4 Composition and Distribution of the Assessment Base***

The assessment of real property constituted between 88 and 95 percent of the assessment base. During the 1920s and 1930s, business assessment increased its share of the base to just over 8 percent. Income assessment never amounted to more than one-half of one percent of the total assessment base until its abolition. Building value only exceeded land value after 1927.

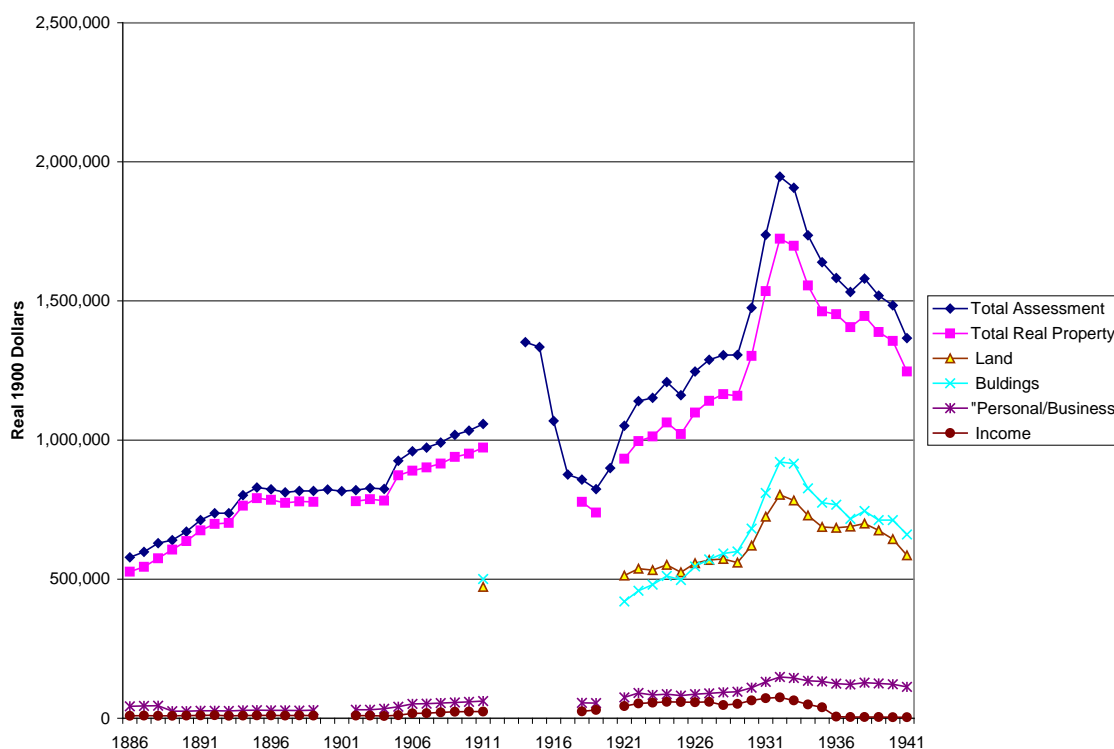
Not surprisingly, in the rural municipalities (townships), the predominance of agricultural land is clear as the total share of real property never falls below 98 percent of the total assessment base of rural municipalities after 1888. In terms of the relative share of land versus buildings in rural areas, the value of buildings increases its share in the total of real property assessment to 38.5 percent by 1941 from 28 percent in 1921. In the urban category, from 1886 to 1941, real property formed between 87 and 92 percent of the assessment base with business assessment varying from 7 to 10 percent. In these towns and villages, buildings on average formed about 70 percent of the value of real property. Again, not surprisingly, the most diversified assessment base is to be found in the cities. After the introduction of business assessment in 1904, real property occupied between 83 and 88 percent of the assessment base. The increase in the relative importance of real property after 1936 is clearly due to the repeal of the right to tax income at the municipal level. Income assessment reached a peak of 7.4 percent

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of Canada's GDP during this period: "it appears that in 1891 and possibly 1892 there were wide regional variations with residential construction strong in Toronto and the west and declining elsewhere. Thus, Montreal declined substantially, and there are signs that happened also in Ottawa. ... the alternative series are remarkably unanimous in their picture of the years from 1901 to 1911. The downturn in the residential series in 1912 casts some doubt, however, on the stratospheric heights our series show for the non-farm peak reached in that year. Increased commercial and industrial building may have pushed the urban indicator up and increased loans per dwelling unit may have pushed the mortgage distributor up, together producing an unwarrantedly high peak in our favoured estimates. On the other hand, property transfer data for York and for Greater Toronto show a very pronounced peak in 1912 (Buckley (1955, Table P,144). Greater Toronto includes suburban areas which grew much faster after 1910 than the City of Toronto;"

in 1924 while business assessment continued to increase its share of the assessment base to 1941. By 1921, buildings accounted for 51 percent of real property and their share in value relative to land increased to close to 60 percent at times during the subsequent twenty years. These numbers are consistent with the urbanization of population and employment during the interwar period.<sup>41</sup>

**Figure 7. Assessment Trends, 1886-1941 (\$1900s)**



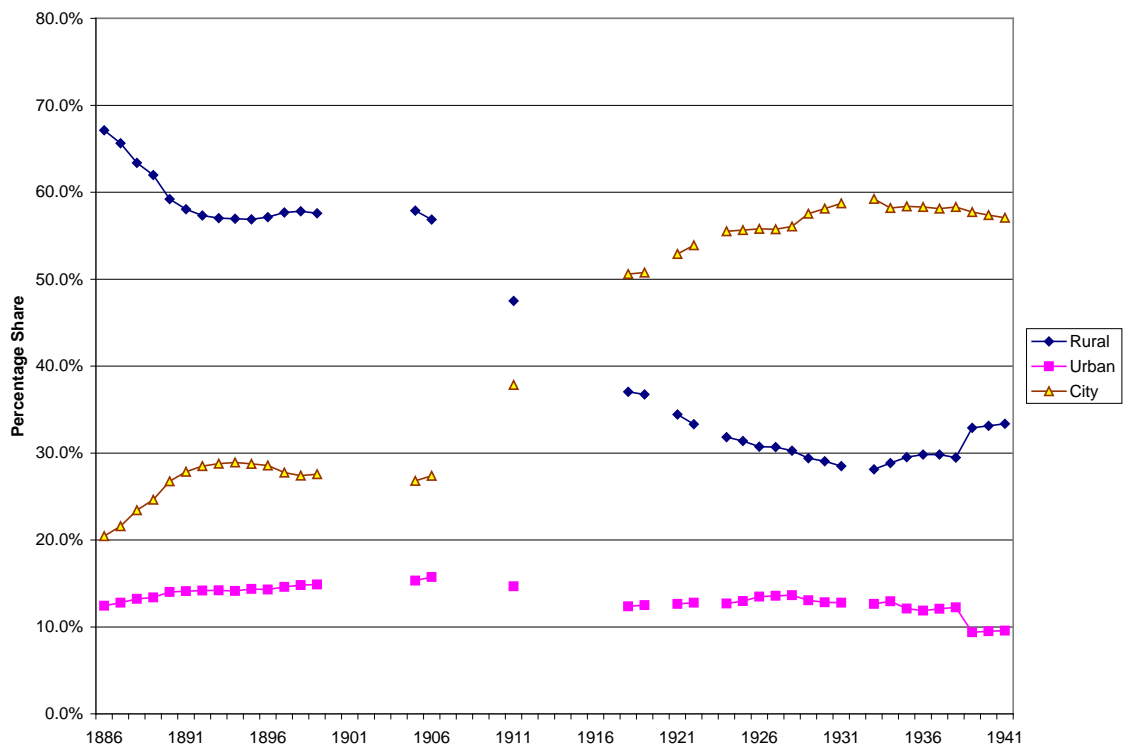
Source: Author’s Calculations and Annual Reports of the Ontario Bureau of Industries and Department of Municipal Affairs.

With urbanization, the relative share of the real property assessment base among the three broad categories of municipalities also changed. During the late 1880s, over 60 percent of the

<sup>41</sup> Steele (1993, 569) commenting on residential starts estimated for the country as a whole notes: “The twentieth century did not open auspiciously, with a decline in immigrants and total starts in 1900. Starts rose the following year, however, and in 1903 took off. In residential construction, from then until 1912, the twentieth century certainly belong to Canada. (sic). Although the credit crunch in 1906 and 1907 and the sharp fall in immigrants in 1908 took their toll, especially in 1908, the recovery in 1909 was very great. By 1912 the level of starts was over four time (sic) as great as in 1900.”

assessed value of real property was located in the rural areas of the province, dipping below that mark in the 1890s. The cities had just under 30 percent of the real property assessment during that period. By 1910, the rural share had fallen to below 50 percent. During the war, the city share increased above 50 percent, peaking in 1933 at around 59 percent. During the 1920s and early 1930s, the rural areas retained about 30 percent of the real property assessment in the province. These trends are shown in Figure 8.

**Figure 8. Changing Share of Real Property Assessment by Type of Municipality, 1886-1941**



Source: Author’s Calculations and Annual Reports of the Ontario Bureau of Industries and Department of Municipal Affairs.

Table 7 shows the quinquennial average (data permitting) of the annual ratios of the percentage share of assessment relative to the percentage share of population. (A value equal to 1.00 indicates complete congruency.) It is only after the Great War that the cities’ share of assessment relative to population is consistently above one. In terms of this measure, the smaller

towns and villages had relatively less assessment compared to population share, in part a consequence of having an assessment base that was overwhelmingly residential. The index thus reflects the relatively greater share of commercial and industrial and higher valued residential assessment in cities.

**Table 7. Average Assessment Relative to Population**

|         | <b>Rural</b> | <b>Urban</b> | <b>City</b> |
|---------|--------------|--------------|-------------|
| 1886-90 | 1.049        | 0.691        | 1.137       |
| 1891-95 | 0.998        | 0.719        | 1.247       |
| 1896-00 | 1.032        | 0.722        | 1.160       |
| 1901-05 | 1.149        | 0.709        | 0.956       |
| 1906-10 | 1.160        | 0.717        | 0.945       |
| 1911-15 | 1.101        | 0.650        | 1.103       |
| 1916-20 | 0.962        | 0.616        | 1.222       |
| 1921-25 | 0.876        | 0.653        | 1.265       |
| 1926-30 | 0.836        | 0.686        | 1.268       |
| 1931-35 | 0.807        | 0.678        | 1.278       |
| 1936-41 | 0.941        | 0.510        | 1.243       |

Source: Author's calculations.

Thus, the rural share of the assessment base was commensurate with its share of population, while the cities' share was greater. By implication, the rural areas and the cities had a share of the tax base more congruent to their needs while the smaller urban centres did not. As shown in the next chapter, a weaker tax base would have deleterious consequences particularly after 1925 as most of the supervised municipalities were in the "urban" category. This weakness is also apparent in Table 8 which shows both the fall in the share of real (land and buildings) property assessment and in real property assessment per capita in the urban category.

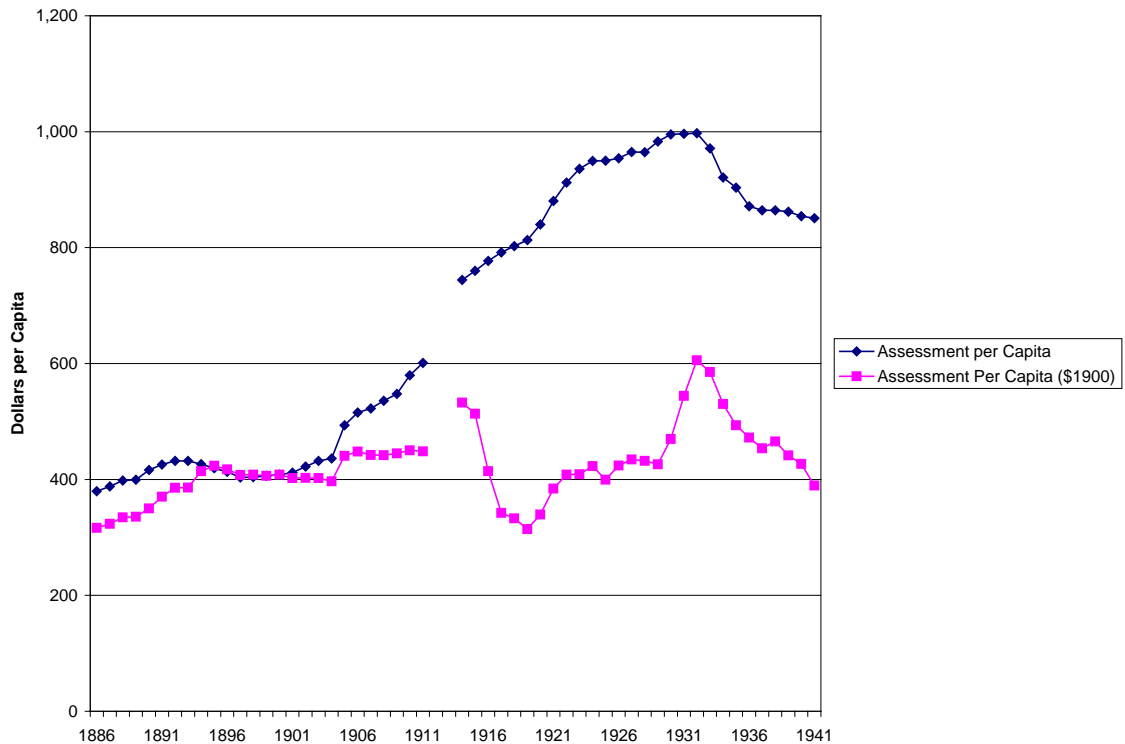
**Table 8. Real Property Assessment: Rural, Urban, City.**

| <b>Share of Real Property</b>                  |                |              |             | <b>Total Assmt.</b> |               |
|--|----------------|--------------|-------------|---------------------|---------------|
| <b>Assessment</b>                              |                |              |             | <b>Per Capita</b>   |               |
|  | <b>Rural</b>   | <b>Urban</b> | <b>City</b> | <b>Current</b>      | <b>\$1900</b> |
|  | <b>%</b>       | <b>%</b>     | <b>%</b>    | <b>\$</b>           | <b>\$</b>     |
| <b>1886-99</b>                                 | 59.6           | 14.0         | 26.5        | 410                 | 377           |
| <b>1924-34</b>                                 | 29.9           | 13.1         | 57.1        | 968                 | 479           |
| <b>1935-41</b>                                 | 31.1           | 11.0         | 57.9        | 867                 | 449           |
| <b>Average Real Property Assmt. Per Capita</b> |                |              |             |                     |               |
|  | <b>Rural</b>   | <b>Urban</b> | <b>City</b> | <b>Prov.Avg.</b>    |               |
|  | <b>Current</b> |              |             |                     |               |
|  | <b>\$</b>      | <b>\$</b>    | <b>\$</b>   | <b>\$</b>           |               |
| <b>1886-99</b>                                 | 397            | 275          | 459         | 387                 |               |
| <b>1924-34</b>                                 | 711            | 592          | 1088        | 857                 |               |
| <b>1935-41</b>                                 | 697            | 557          | 988         | 790                 |               |

Source: Author's Calculations.

In terms of trends in per capita assessment, measured in current dollars, there is a steady increase from 1903 to 1932, from \$432 per capita to just under \$1000 per capita in 1932. In 1900 purchasing power, the series shows an almost constant level from 1894 to 1904 around \$410 per capita, growth to 1914 (\$533) a decline to 1918 (\$314) and an increase to \$606 by 1932 with a subsequent decline to \$389 by 1941 (see Figure 9).

**Figure 9. Trends in Assessment Per Capita**



Source: Author's calculations and the Annual Reports of the Department of Municipal Affairs.

While not specifically referencing Ontario, the following from Rowell-Sirois seems to be appropriate, particularly with respect to the suburban municipalities that would experience serious fiscal difficulties during the 1930s.

The post-war slump which drove down property values caused many municipalities acute embarrassment in the early years of the decade (1920s). Moreover, the increased use of the automobile had a serious and adverse effect upon the tax base in many of the larger urban centres. At the very time, when it was compelling large expenditures on the improvement of streets, it promoted the rapid growth of new residential districts outside the boundaries of the city. This flight to suburban areas had a depressing effect upon property values within the central municipality. However, the economic expansion of the twenties, combined with rapid urban

growth, came as an important counteracting influence, supporting property values and strengthening the tax base for the time being.<sup>42</sup>

Cryptically, the Commission noted that “anything which had an adverse effect on real estate values would undermine Canadian municipal finances.”<sup>43</sup>

### ***2.5.5 Trends in Local Taxes and Fees Levied (Imposed) and Received***

The following section examines the long-run trends in taxes and levies imposed by municipalities. There is sufficient consistency in the data to chart the fiscal effort exerted by municipalities to finance both traditional municipal and education services. These trends were affected by external shocks- both legislative and economic. With urbanization, the tax effort of cities grew both absolutely and relatively to the tax effort in the rural and smaller municipalities.

From 1886 to 1941, the most conceptually and arithmetically consistent tax data is that for total local taxes levied or imposed. This number includes taxes levied for both municipal and school purposes, including taxes levied on real property, business taxes after 1904 and income taxes levied up to 1936. However, taxes on real estate accounted for approximately 90 percent of taxation from 1913 to 1937 and the related taxes on business levied on the basis of a percentage of assessed value (“other taxes”) another 6 to 10 percent of total taxation, particularly in more urbanized jurisdictions. In Toronto, during the 1920s, the share of property taxation was approximately 84 percent with both business and income taxation providing some diversification within the overall tax mix. As Perry notes: “the City of Toronto appears to have carried the municipal income tax to its fullest development” and it is estimated that during the 1920s collected half the estimated national total of municipal income tax of about \$5-6 million.<sup>44</sup>

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<sup>42</sup> RCDPR (1940 v. 1, 130).

<sup>43</sup> RCDPR (1940 v. I, 130). This position echoes the lobbying efforts of the real estate boards.

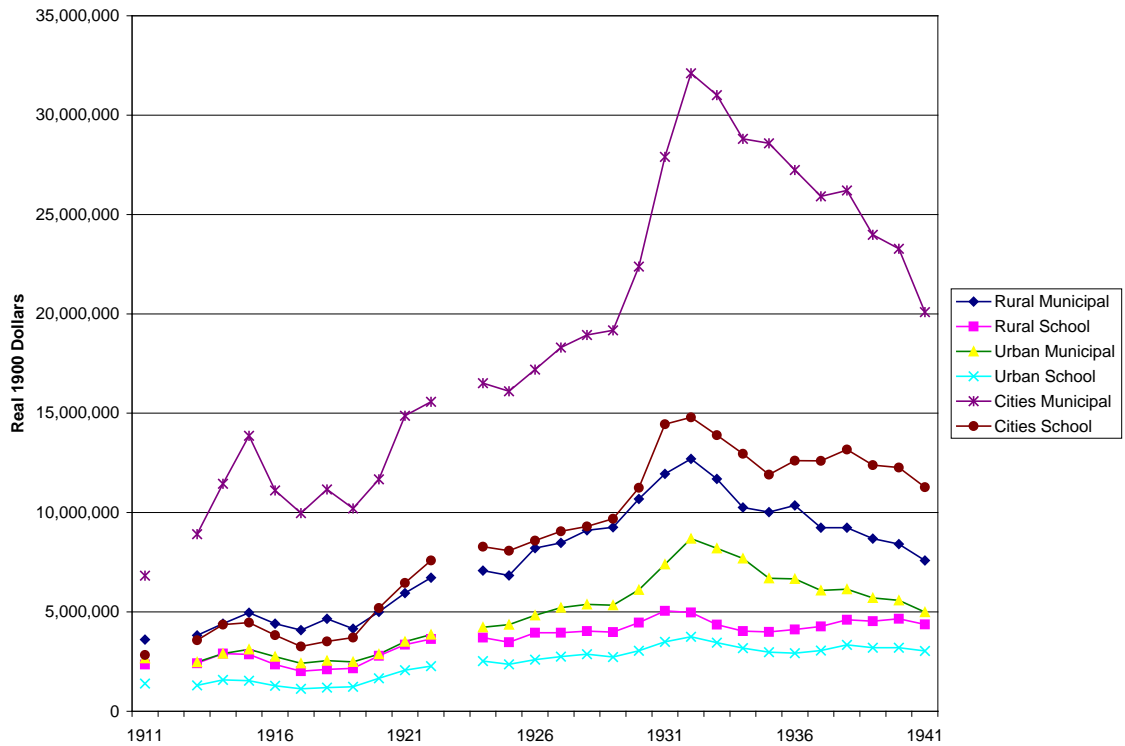
<sup>44</sup> Perry (1955, v. 1, 245). A short description follows below.



In the late 1860s, the Province estimated local taxes collected at approximately \$3.2 million. By the time the data collection process became more systematic (and probably the tax collection system as well), in the late 1880s, local taxes imposed had just surpassed \$9.0 million and reached nearly \$11 million in 1890. By 1911, the total taxes imposed had reached \$26.4 million in current dollars. In terms of 1900 purchasing power, local taxes imposed increased from \$7.5 million in 1886 to \$19.7 million in 1911 (Figure 10). In per capita current dollars, the average amount of local taxes imposed from a provincial average of \$5.89 (1886-99) to \$8.75 in the first decade of the twentieth century (1902-11). In constant dollars, the average local tax per capita increased from \$5.43 to \$7.41.

The increase in local taxes imposed continued inexorably until the Great Depression. Specifically, in current dollars, by 1914, nearly \$40 million or approximately \$28 million in 1900 purchasing power was raised; from 1911 to 1914, this represented an increase of 37 percent in real terms. By 1922, the current dollar figure stood at \$89 million but a substantial portion of this increase was due to inflation as the deflated value is approximately \$40 million. Still, over a decade, the percentage increase was just over 42 percent.

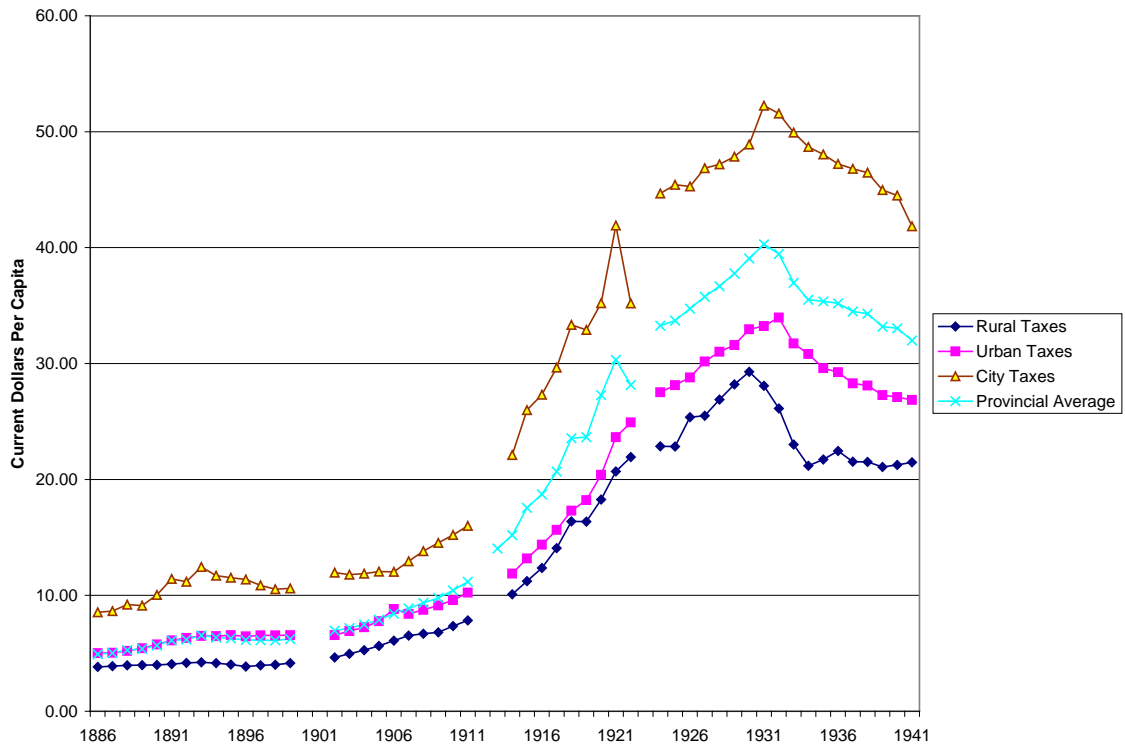
**Figure 10. Local Taxes Imposed, 1911-1941 (\$1900s)**



Source: Author's calculations and the Annual Reports of the Department of Municipal Affairs.

The peak in total local taxes imposed in current dollars was reached in 1931 at \$128 million; the constant dollar peak occurred a year later, in 1932 at \$72 million. Thereafter, by 1941, the current dollar total had declined to \$112 million or \$51 million in 1900 purchasing power. In current dollar terms, local taxes imposed increased and then declined during the Great Depression until falling below the 1929 level of taxes of \$115 million in 1939. In 1900 purchasing power, the taxes imposed also rose and fell but only by 1941 did the total fall below the 1930 level of taxes imposed.

**Figure 11. Local Taxation Per Capita (Current Dollars)**



Source: Author's calculations and the Annual Reports of the Department of Municipal Affairs.

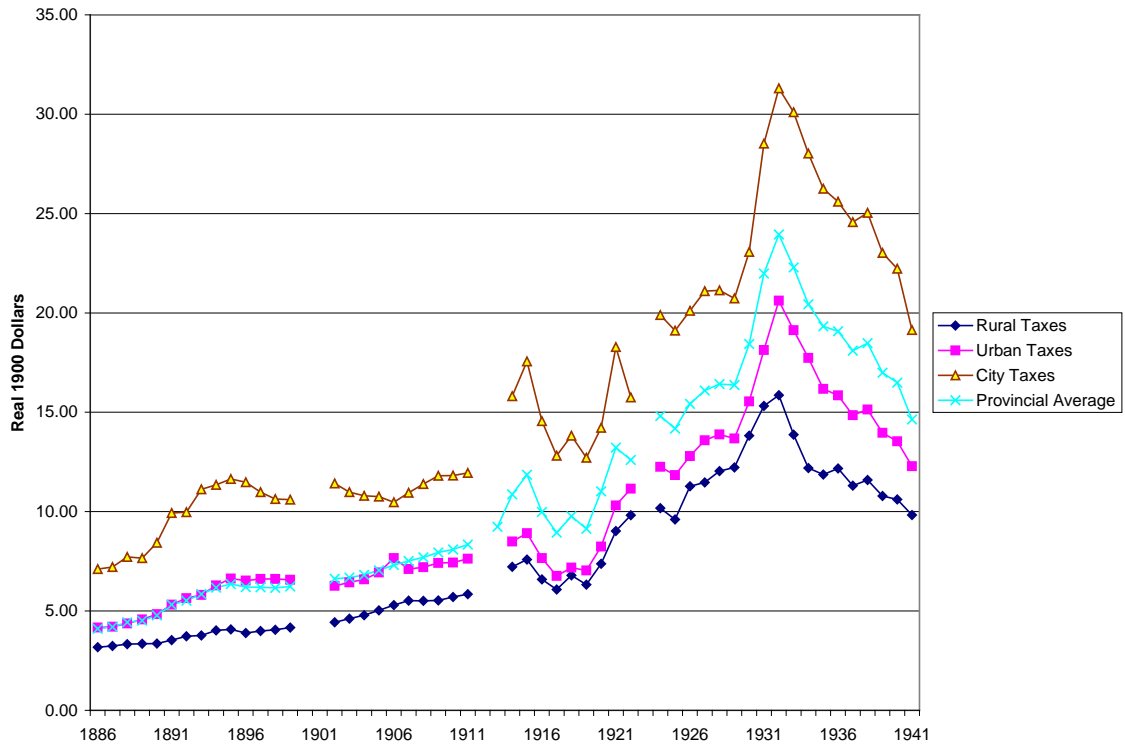
In per capita terms, the provincial average total of local taxes imposed increased from \$23 for the period 1914-22 to \$35 for the period from 1924-1929 and to \$38 for the period 1929-34 (Table 9). The decline in aggregate taxes relative to population results in a reduction of the average for the period 1935-1941 to \$34. In real terms (1900 purchasing power), per capita taxes increased to an average of \$15 (1924-1929) from the average in the period 1914-1922 of \$11. The real per capita average for 1924-1941 is \$18, a small increase rather than the decrease in current dollar terms- a consequence of the general deflation taking place during the depression. This masks the real increase in tax burden per capita that took place during the worst years of the Great Depression, when taxes rose by a third on average during the period, 1929-34, from the average levels prevailing from 1924-29 and real local taxes per capita exceeded \$20.

**Table 9. Local Taxes Per Capita**

|                | Local Taxes Per Capita |       |                 |                       | Local Taxes Per Capita |       |         |                       |
|----------------|------------------------|-------|-----------------|-----------------------|------------------------|-------|---------|-----------------------|
|                | Current Dollars        |       | Current Dollars |                       | \$1900s                |       | \$1900s |                       |
|                | Rural                  | Urban | Cities          | Provincial<br>Average | Rural                  | Urban | Cities  | Provincial<br>Average |
| <b>1886-00</b> | 4.04                   | 6.08  | 10.55           | 5.92                  | 3.73                   | 5.65  | 9.79    | 5.50                  |
| <b>1901-11</b> | 6.02                   | 8.08  | 13.00           | 8.53                  | 5.15                   | 6.92  | 11.17   | 7.29                  |
| <b>1914-22</b> | 15.71                  | 17.73 | 31.51           | 22.79                 | 7.42                   | 8.42  | 15.06   | 10.82                 |
| <b>1924-29</b> | 24.69                  | 29.13 | 45.89           | 34.83                 | 10.91                  | 12.87 | 20.27   | 15.39                 |
| <b>1929-34</b> | 25.98                  | 32.38 | 49.86           | 38.17                 | 13.88                  | 17.48 | 26.96   | 20.58                 |
| <b>1935-41</b> | 21.58                  | 28.07 | 45.69           | 33.93                 | 11.17                  | 14.54 | 23.69   | 17.58                 |
| <b>1924-41</b> | 23.91                  | 29.80 | 47.13           | 35.59                 | 12.00                  | 15.06 | 23.83   | 17.97                 |

Source: Author's calculations.

**Figure 12. Real Per Capita Local Taxes (\$1900s)**



Source: Author's calculations and the Annual Reports of the Department of Municipal Affairs.

Aggregating local taxes by municipal structure permits a comparison of the change in the annual average distribution of local taxation in selected intervals from 1886 to 1941. (See Table 10.)

Before the turn of the century, the share of total local taxes imposed in cities and in rural townships was already close to equal.

**Table 10. Percentage Distribution of Local Taxes Imposed**

|                  | <b>Rural</b> | <b>Urban</b> | <b>Cities</b> |
|------------------|--------------|--------------|---------------|
|                  | <b>%</b>     | <b>%</b>     | <b>%</b>      |
| <b>1886-1900</b> | 39.7         | 20.2         | 40.1          |
| <b>1901-1911</b> | 34.5         | 20.8         | 44.8          |
| <b>1913-1922</b> | 26.8         | 15.8         | 57.4          |
| <b>1923-1932</b> | 25.5         | 16.1         | 58.3          |
| <b>1933-1941</b> | 22.3         | 15.4         | 62.3          |

Source: Author's calculations and the Annual Reports of the Department of Municipal Affairs.

After 1900, the cities' share of the total continues to increase relative to the share of total taxes imposed in smaller urban municipalities and rural townships. This too is a reflection of the urbanization of the province, particularly up to the early 1920s. Given the incompleteness of expenditure numbers, particularly with respect to smaller municipalities, the percentage distribution of tax is a more accurate indicator of the relative importance in terms of taxing, spending and service provision of the various types of municipalities, further highlighting the urbanization of the province.

### ***2.5.6 Municipal Income Tax***

Ironically, with urbanization came a reduction in the diversity of tax instruments available to local governments. While the authority to tax income (personal and corporate) locally existed from 1850, its significance in the overall local revenue structure was small relative to property taxation. The base of the tax was narrowly defined and collection effort was weak. With the repeal of the personal property tax in 1904, various reforms were introduced in an effort to improve the effectiveness of the income tax. Source reporting of salaries, wages and other payments was introduced. For taxpayers whose profession was dependent on the occupation of real estate, income was exempted and their property was subject to the new

business tax. Assessors could increase the business tax when the income of the individual from the profession exceeded the amount of the business assessment on the occupied property.<sup>45</sup>

Farm and real estate income (except interest on mortgages) and dividends from companies subject to income tax in the province continued to be exempt. This field of taxation, however, would ultimately be invaded by the other two levels of government and, in 1917, the federal government even borrowed the statutory wording for the definition of income.

In 1935, personal and corporate income assessment constituted only 2.4 percent of the total taxable assessment of Ontario municipalities. (The relative magnitude and patterns of growth in the changing sources of revenues will be discussed in more detail later.)<sup>46</sup> In 1936, the Ontario government deliberately terminated the municipal income tax and replaced it by a provincial levy.<sup>47</sup> Although the municipal income tax, both personal and corporate, had been a required supplement to the property tax, a number of municipalities did not comply and were perceived as tax havens for the well-to-do.<sup>48</sup> By 1928, the temptation to indulge in tax competition or rather avoidance was obviously too great and municipal behaviour in this respect was one of the topics under discussion at the Canadian Tax Conference of that year. As noted:

“Under the Assessment Act, all municipalities are required to assess for income just as they do for real property. However, many assessors ignore income altogether, and whole colonies of persons with large incomes may be found in certain municipalities where this practice is known to exist. The chief reason for this non-assessment of income is the method of assessment for county rates. If a township assessed properly these millionaire districts, its total assessment would be out of all proportion to its neighbours, and so it would bear the brunt of the county rates. This would mean an

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<sup>45</sup> Perry (1955, 133).

<sup>46</sup> See Bradshaw (1932) on the merits of revenue diversification.

<sup>47</sup> The Rowell-Sirois Commission recommended that “the provinces and *ipso facto* their municipalities should withdraw entirely from the personal income tax field”, citing the need for a centralized control over rates, exemptions and the “appropriate curve of progressivity” (RCDPR, (1940, 111-112). In their discussion, the Report cites the early Ontario initiative to eliminate municipal income taxes approvingly.

<sup>48</sup> Ontario Committee on Taxation (1967 v.2, 46).

increased tax rate for its ratepayers as a whole and, while it would not to any extent hurt the rich, it would be considered a serious burden by the farmers. This non-assessment is the real reason why persons with large incomes choose to take up residence in these municipalities and not, as many believe, because tax rates are lower in rural municipalities. As a matter of fact, the tax rates are usually higher than in the cities.”<sup>49</sup>

This theme of the unevenness in the application of this tax was used by the Province as an excuse (justification) for provincial intervention.<sup>50</sup> In his Budget Address of 1937, Premier Hepburn commented that:

“This Act replaced the disgraceful checkerboard system of municipal income tax, full of inequalities, anomalies and hardships. While the Government has, up to this point, been accused of invading a field of municipal taxation, this budget demonstrates that the administration has only acted in the best interests of the taxpayers of Ontario as a whole and, through a system of tax reduction, has more than restored any benefits considered lost by the municipalities. Our measure has, at least, something to do with equity, justice and uniformity.”<sup>51</sup>

Simultaneously, Ontario negotiated a tax collection agreement with the federal government. The Province also replaced the revenue-loss with a one-mill subsidy which when added to some temporary fire and police grants became the basis for an unconditional grants program that continues to persist in a modified form.

The Province had instituted selective corporate income taxes in 1899; however, a general corporate income tax with a flat levy of 1 percent was not instituted until 1932. Thus, during the

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<sup>49</sup> Perry (1955 v. 1, 249). At this time, the Village of Forest Hill was not in the city of Toronto. See Wildasin (2005) for a discussion of local tax competition and the evasion of responsibility in shared tax situations.

<sup>50</sup> In 1935, Hepburn indicated his support for “ability to pay” as a “measuring stick” for taxation but then went on to note that “...every time the Dominion of Canada reaches out its hand and takes income tax from residents of the Province of Ontario, it is taking that which properly belongs to the Province and to the Municipalities, and multiplies the difficulties of both. It would appear that the failure of the Province to enter this field has encouraged these fresh exactions, and the time has come when the ill-balanced incidence of taxation in Municipalities has so contributed to unemployment that the Province can no longer disregard the plea of municipalities for consideration.” (Ontario, 1935, 15)

<sup>51</sup> Mitchell F. Hepburn (1937 Budget Address, 11-12) as cited in Hartle (1982, 64). Note Bradshaw (1932)’s comments about Windsor’s fiscal plight and the merits of levying an income tax in Tassonyi(2011).

period under scrutiny, the two most significant provincial initiatives with respect to local fiscal capacity were the introduction of “business occupancy taxes” in 1904 and ending municipal authority to levy income taxes in 1936.

### ***2.5.7 Sharing Local Taxes***

After 1911, the published municipal data reports the amounts levied for municipal and school purposes separately.<sup>52</sup> By the middle of the First World War, just over half the school taxes and sixty percent of the municipal taxes in the province were imposed in cities. The rural share of municipal taxes increased somewhat during the latter part of the 1920s, in part reflecting the opening up of northern Ontario. However, by the beginning of World War II, the rural share of both municipal and school taxation had declined relative to cities in particular. The school tax share of urban areas (towns and villages) outside of cities also declined, while the urban share of total municipal taxes in the province stayed more or less constant.

**Table 11. Percentage Distribution of Taxes Imposed by Function as a Percent of the Provincial Total**

|                | Rural     |        | Urban     |        | Cities    |        |
|----------------|-----------|--------|-----------|--------|-----------|--------|
|                | Municipal | School | Municipal | School | Municipal | School |
|                | %         | %      | %         | %      | %         | %      |
| <b>1911-22</b> | 24.9      | 31.1   | 15.3      | 17.8   | 59.8      | 51.1   |
| <b>1924-32</b> | 26.1      | 24.2   | 15.9      | 16.8   | 58.0      | 59.0   |
| <b>1933-41</b> | 22.6      | 21.6   | 15.2      | 15.7   | 62.2      | 62.7   |

Note: The municipal shares and school shares by type of municipality add to 100 percent.

Source: Author’s calculations and the Annual Reports of the Department of Municipal Affairs.

In terms of the sharing of the local tax base over time, approximately one-third of the local taxes imposed were for school purposes throughout the period (1911-1941) and across all

<sup>52</sup> It is possible to obtain an estimate of school taxes levied prior to 1911 from Ministry of Education reports. This series will be discussed later below. Urquhart used the education tax data to estimate the annual fluctuations in local taxation for the years after 1870 for which annual data was not available. (Urquhart,1993, 695)



categories of municipal structure. While the school share of taxes imposed was higher than the overall average for the whole period from 1911-22 in the rural and small urban areas and lower than the average during that period in the cities, on the whole, the differences in school share over time and among category of municipality were not large. (These averages mask some annual variation, shown in the more detailed discussion of tax- base sharing in Tassonyi (2011).

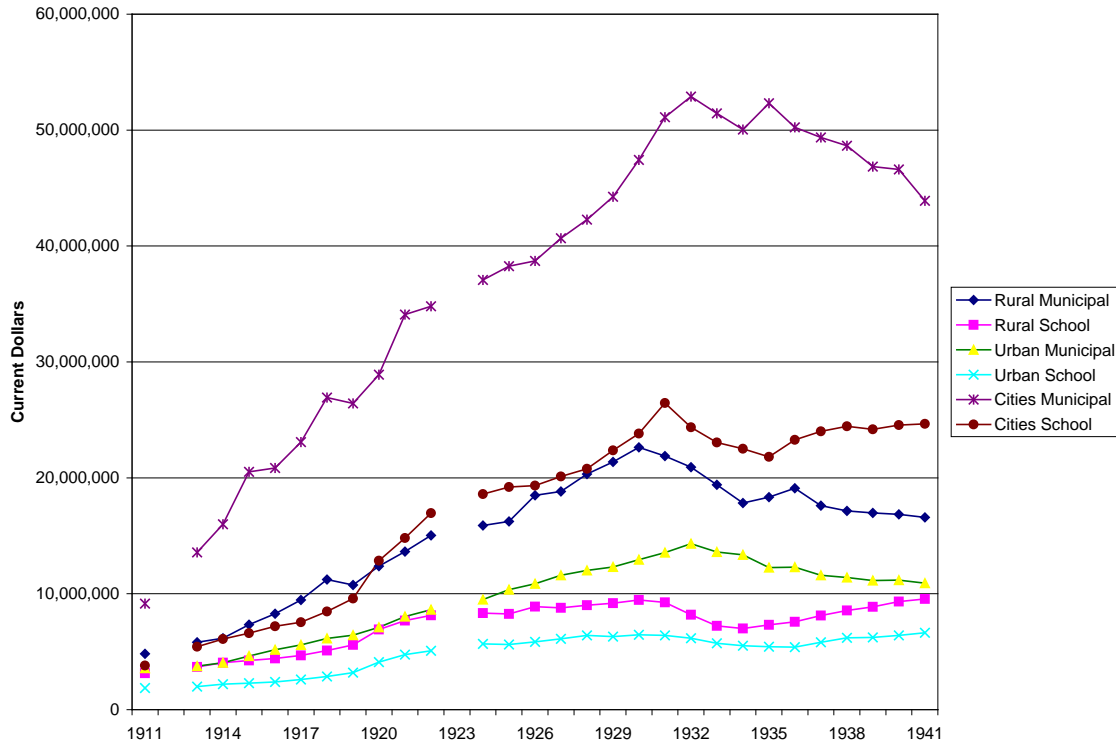
**Table 12. Share of Taxes Imposed by Municipal Category**

|                | <b>Rural</b>     |               | <b>Urban</b>     |               | <b>Cities</b>    |               | <b>Total</b>     |               |
|----------------|------------------|---------------|------------------|---------------|------------------|---------------|------------------|---------------|
|                | <b>Municipal</b> | <b>School</b> | <b>Municipal</b> | <b>School</b> | <b>Municipal</b> | <b>School</b> | <b>Municipal</b> | <b>School</b> |
| <b>1911-22</b> | 64.1             | 35.9          | 65.8             | 34.2          | 72.3             | 27.7          | 69.1             | 30.9          |
| <b>1924-32</b> | 68.8             | 31.2          | 66.0             | 34.0          | 66.8             | 33.2          | 67.2             | 32.8          |
| <b>1933-41</b> | 68.5             | 31.5          | 66.8             | 33.2          | 67.4             | 32.6          | 67.5             | 32.5          |
| <b>1924-41</b> | 68.7             | 31.3          | 66.4             | 33.6          | 67.1             | 32.9          | 67.3             | 32.7          |
| <b>1911-41</b> | 66.9             | 33.1          | 66.1             | 33.9          | 69.1             | 30.9          | 68.0             | 32.0          |

Source: Author's calculations and the Annual Reports of the Department of Municipal Affairs. See Chapter 6.

In nominal terms, from 1911 to 1922, school taxes in cities increased from \$3.8 million to \$16.9 million; taxes for municipal purposes also rose almost fourfold, from \$9.1 million to nearly \$35 million as shown on Figure 13. In real terms, school taxes tripled while municipal taxes doubled in the cities. In real terms, the total taxes imposed in rural areas for municipal purposes also nearly doubled, again related to the establishment of organized municipalities in central and northern Ontario (Figure 13) By 1921, taxes imposed for school purposes in cities exceeded the taxes imposed for municipal purposes in the rural townships and by 1924 the total of local taxes imposed in towns and villages.

**Figure 13. Distribution of Local Taxes, 1911-1941**



Source: Annual Reports of the Department of Municipal Affairs.

From 1924 to 1932, the most significant increase in real terms took place in the total taxes for municipal purposes, with total taxes increasing by one-third from 1929 to 1932, from \$19 million to \$32 million, reflecting the impact of both price deflation and actual pressure to increase taxes to fund municipal services. The increase in current dollars during this period, from \$44 million to \$53 million was about 18 percent.

Figure 17, (below) shows clearly the increase in the real burden of taxation (1900 purchasing power) for municipal purposes in rural and small-town Ontario as well, with the peak being reached in 1932. After that date, the real burden of local taxation fell and by 1941 reached or was slightly below the levels prevailing in 1929.

The following table shows the quinquennial average for the ratio of the share of taxes relative to the share of population. (A value close to 1 implies congruency in the share of taxes and population.) It is clear that cities accounted for a greater share of the municipal taxation in the province relative to the share of population, with access to the non-residential property tax base. A comparison with the index numbers for assessment relative to population shows that tax shares were closer to population shares in small urban areas and the converse in rural areas. This implies relatively lower levels of taxation on farmland.

**Table 13. Average Tax Index Relative to Population**

|                | <b>Rural</b> | <b>Urban</b> | <b>Cities</b> |
|----------------|--------------|--------------|---------------|
| <b>1886-90</b> | 0.749        | 1.006        | 1.732         |
| <b>1891-95</b> | 0.655        | 1.016        | 1.850         |
| <b>1896-00</b> | 0.650        | 1.061        | 1.763         |
| <b>1901-05</b> | 0.694        | 0.965        | 1.619         |
| <b>1906-10</b> | 0.715        | 0.956        | 1.462         |
| <b>1911-15</b> | 0.669        | 0.816        | 1.456         |
| <b>1916-20</b> | 0.680        | 0.756        | 1.398         |
| <b>1921-25</b> | 0.703        | 0.824        | 1.338         |
| <b>1926-30</b> | 0.735        | 0.840        | 1.284         |
| <b>1931-35</b> | 0.639        | 0.850        | 1.337         |
| <b>1936-41</b> | 0.640        | 0.825        | 1.344         |

Source: Author's calculations.

A comparison of the average annual growth rates<sup>53</sup> in per capita city taxes in nominal and real terms for municipal and school purposes is shown on Figures 14 and 15.

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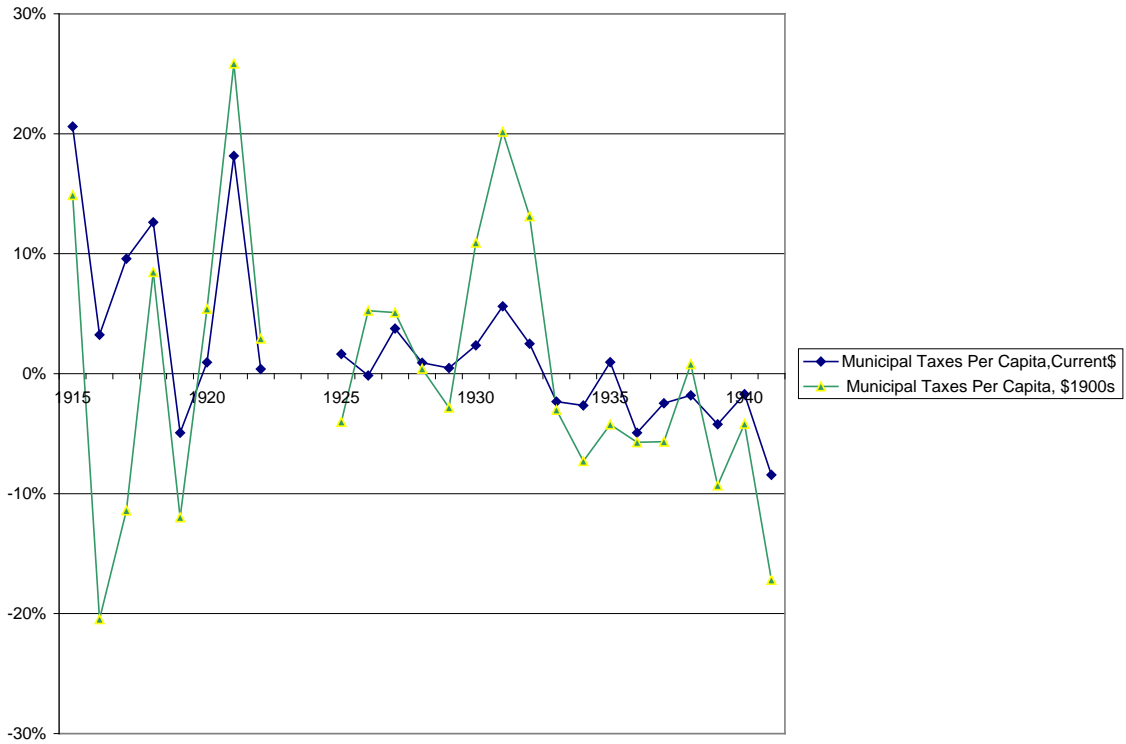
A.1.1. <sup>53</sup> Growth rates are calculated using the formula:

$$r(t) = \ln [ T(t+1) / T(t) ] \text{ where: } t = \text{year}$$

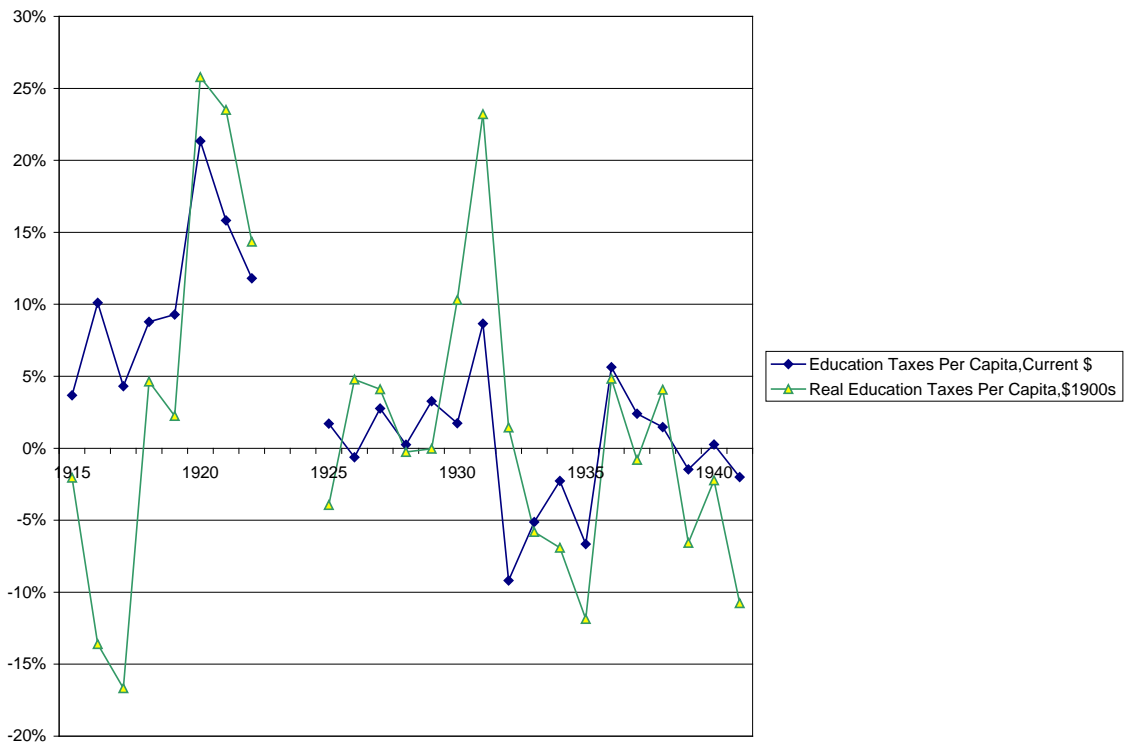
$$r(t) = \text{growth rate from year } t \text{ to year } t+1$$

T(t) = Tax variable reported at year end; ln = natural log

**Figure 14. Growth Rates, City Municipal Tax Per Capita, 1915-1941**



**Figure 15. Growth Rates, City Education Tax Per Capita, 1915-1941**



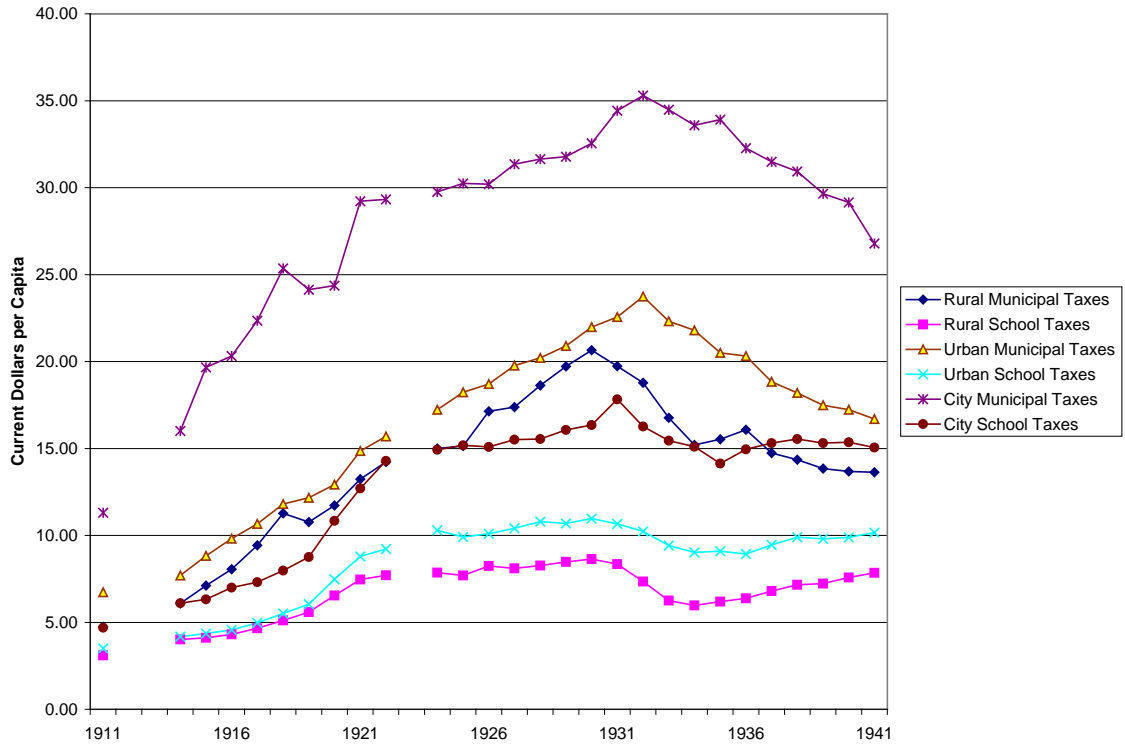
Source: Author's Calculations.

Both charts show the relatively large annual percentage changes that took place in both nominal and real per capita municipal and education taxes in the aftermath of World War I and the subsequent lower annual increases in this measure through the 1920s. The volatility is pronounced in the deflated numbers. The significant annual increases in real and nominal per capita taxation from 1929 to the peak in 1932 are also evident as are the lower rate of increase and in many cases annual reductions in the level of per capita taxation after 1934. Up to 1932, pressure to meet mandatory expenditures and little growth in the assessment base as well as increases in the level of tax arrears combined to put pressure on cities to maintain tax effort. Subsequently, cities made further fiscal adjustments to meet the circumstances of the 1930s.

After 1935, city school taxes per capita exhibit more stability on an annual basis than municipal taxes per capita. Even in 1941, when nominal municipal per capita taxes fell by 8 percent and 17 percent in real terms, the corresponding reduction in education per capita taxes was only 2 percent in nominal terms and 11 percent measured in 1900 purchasing power. By 1941, the pressure on municipalities to fund relief programs had largely disappeared.

Figure 16 shows the pattern of per capita taxation in current dollars split between municipal and education purposes and by type of municipality. The share of local taxes devoted to education began to increase after 1933 and taxes for municipal purposes declined.

**Figure 16. Municipal & School Taxes Per Capita, 1911-1941 (Current Dollars)**

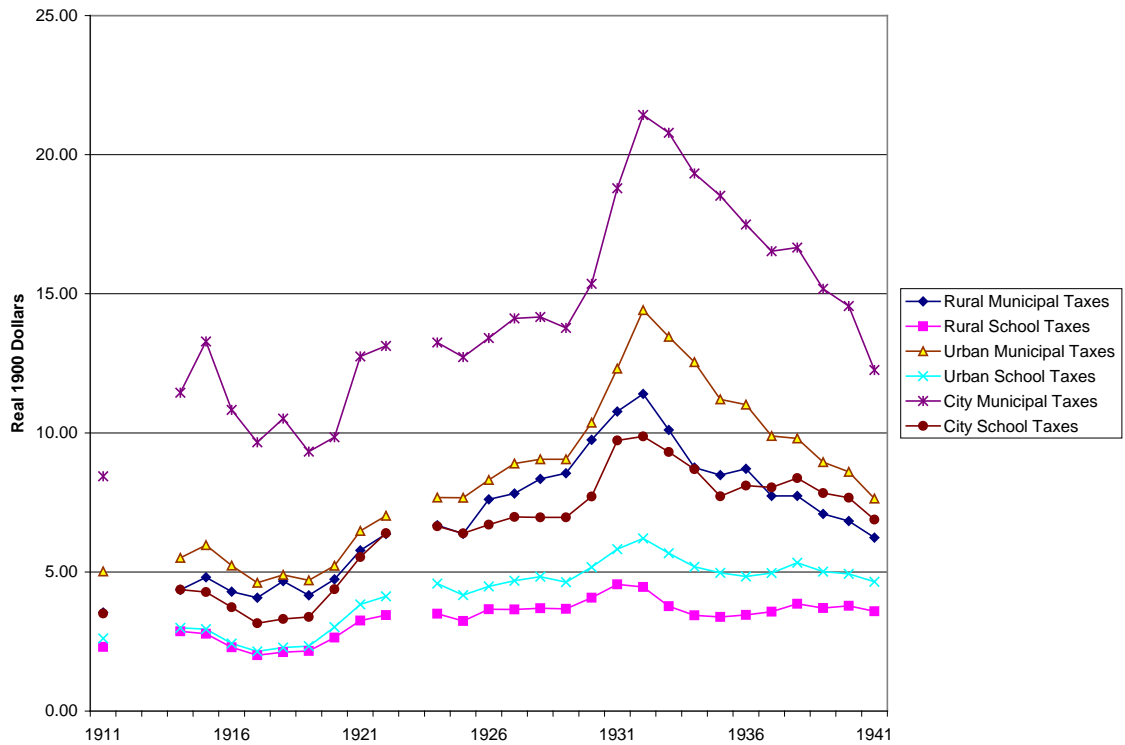


Source: Author's Calculations.

The trends in real per capita taxation are shown in Figure 17. Prior to 1906, the average is dominated by the small urban and rural levels of taxation. The peaks and declines in this chart are consistent with the patterns in the aggregates (see Figure 11). From 1920 to 1941, the three time series increase together to peak in 1932 and then all three decline to 1941.

It is only after 1929 that the real per capita municipal taxes in smaller urban and rural areas diverge. City school taxes per capita exhibit more variation over time compared to the stability in real education tax rates per capita in the other municipal areas of the province.

**Figure 17. Real Per Capita Municipal & School Taxes, 1911-1941 (\$1900s)**



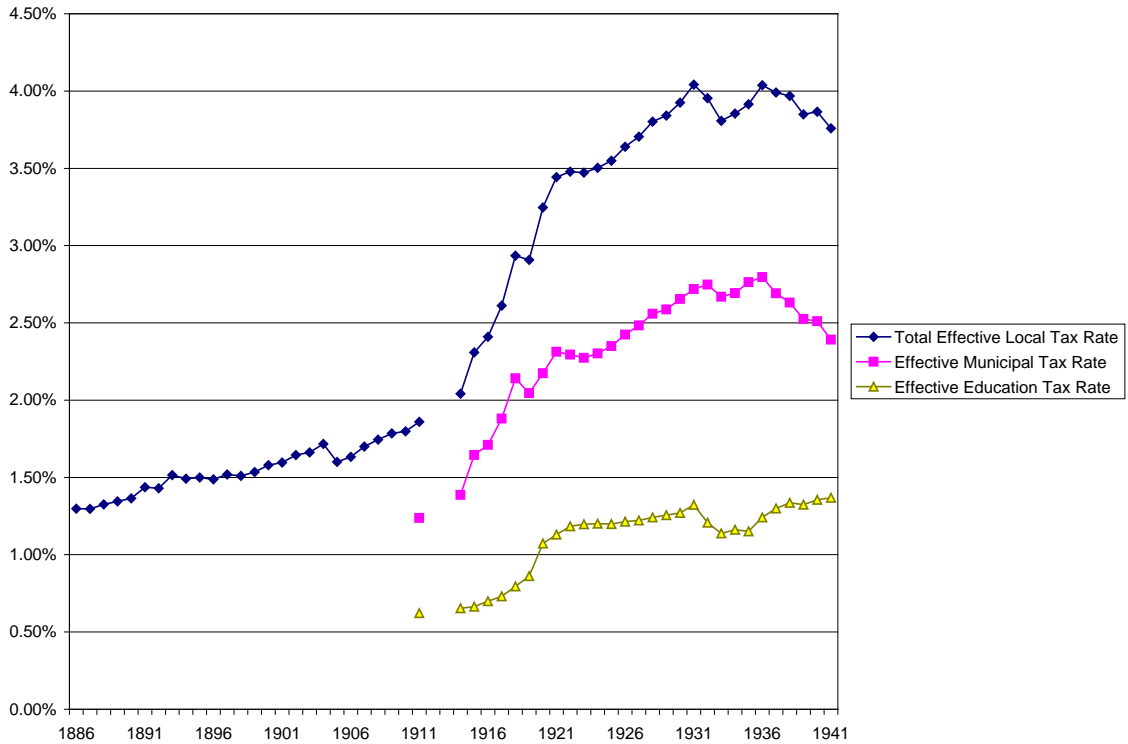
Source: Author's Calculations.

Using the data for total local assessment and total taxes imposed on an annual basis, it is possible to compute percentage effective local tax rates.<sup>54</sup> The chart shows the increase in effective local rates from 1904 to the peak in the early 1930s, from approximately 2 percent in 1913 to 4 percent by 1931. The increase was not confined to municipal purpose taxation as the effective education tax rate also increases to 1931. While municipal rates declined after that with reductions in the aggregate of taxes imposed for municipal services reflecting a decline in the pressure on municipal budgets from relief expenditures and debt charges, the education rates are

<sup>54</sup> Wallis (2003) also uses this concept. While there is some evidence of undervaluation relative to market value between 1910 and 1927 in Toronto and its suburbs, the trend in effective rates also mirrors per capita taxation, which is independent of assessed values. See Harris (1996, 290-292) for an account of the assessment process. An upward adjustment to assessments in the period before 1931 would only increase the steepness in the change in effective rates towards the end of the 1920s although the absolute level would be somewhat reduced.

slowly increasing again. Figure 18 is suggestive in that the 4 percent mark seems to be a ceiling in the level of the total rates and implies a capacity constraint.

**Figure 18. Effective Local Tax Rates – Taxes as a Percentage of Local Assessment, 1886-1941**



Source: Author’s calculations.

Another way to illustrate a capacity constraint is to compare the rise and fall of estimated personal income per capita with the estimate of local taxes per capita. The trend of nominal and real income per capita from 1926 to 1941 is illustrated in the following table. The impact of the depression on incomes is clear in both series. Real taxes per capita peaked at the beginning of the slump.<sup>55</sup> The data suggest that the average percentage of local tax of income was approximately 6.5 percent in the latter years of the twenties, reached 10 per cent in 1931 and

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1932 and then fell. The burden of property tax at this point in time was high compared to current levels of around 3-4 percent of income.

Holcombe and Lacombe (2004), after examining expenditure and revenue trends in Boston and Baltimore in the 19th century, conclude that the growth in local government expenditures in that period was driven more by an increase in the supply of revenues, from a growing property tax base, than by an increase in the demand for services. In their words: “As locational rents made urban living more attractive, property values rose, and local governments were able to capture some of this increase in value by taxing their residents.”<sup>56</sup>

**Table 14. Income and Tax Per Capita**

|  | <b>Personal<br/>Income/<br/>Capita</b> | <b>Local<br/>Tax/<br/>Capita</b> | <b>Real<br/>Income/<br/>Capita</b> | <b>Real<br/>Local<br/>Tax/<br/>Capita</b> | <b>Tax as<br/>a % of<br/>Income</b> | <b>Effective<br/>Tax Rate</b> |
|--|--|----------------------------------|------------------------------------|---|-------------------------------------|-------------------------------|
|  | <b>\$</b>                              | <b>\$</b>                        | <b>\$1900s</b>                     | <b>\$1900s</b>                            | <b>%</b>                            | <b>%</b>                      |
| <b>1926</b>  | 527.97                                 | 34.73                            | 234.50                             | 15.42                                     | 6.6                                 | 3.6                           |
| <b>1927</b>  | 555.21                                 | 35.76                            | 249.92                             | 16.10                                     | 6.4                                 | 3.7                           |
| <b>1928</b>  | 585.78                                 | 36.67                            | 262.35                             | 16.42                                     | 6.3                                 | 3.8                           |
| <b>1929</b>  | 618.55                                 | 37.77                            | 268.01                             | 16.37                                     | 6.1                                 | 3.8                           |
| <b>1930</b>  | 573.59                                 | 39.07                            | 270.71                             | 18.44                                     | 6.8                                 | 3.9                           |
| <b>1931</b>  | 486.50                                 | 40.28                            | 265.57                             | 21.99                                     | 8.3                                 | 4.0                           |
| <b>1932</b>  | 395.32                                 | 39.45                            | 239.98                             | 23.95                                     | 10.0                                | 4.0                           |
| <b>1933</b>  | 368.36                                 | 36.97                            | 222.08                             | 22.29                                     | 10.0                                | 3.8                           |
| <b>1934</b>  | 405.77                                 | 35.50                            | 233.55                             | 20.43                                     | 8.7                                 | 3.9                           |
| <b>1935</b>  | 427.20                                 | 35.36                            | 233.41                             | 19.32                                     | 8.3                                 | 3.9                           |
| <b>1936</b>  | 444.76                                 | 35.19                            | 241.08                             | 19.07                                     | 7.9                                 | 4.0                           |
| <b>1937</b>  | 497.06                                 | 34.49                            | 260.93                             | 18.11                                     | 6.9                                 | 4.0                           |
| <b>1938</b>  | 498.79                                 | 34.29                            | 268.72                             | 18.47                                     | 6.9                                 | 4.0                           |
| <b>1939</b>  | 514.94                                 | 33.18                            | 263.62                             | 16.99                                     | 6.4                                 | 3.8                           |
| <b>1940</b>  | 591.22                                 | 33.03                            | 295.24                             | 16.49                                     | 5.6                                 | 3.9                           |
| <b>1941</b>  | 720.65                                 | 31.99                            | 329.70                             | 14.63                                     | 4.4                                 | 3.8                           |
| Note: Effective tax rate equals tax as a percentage of total assessment. |  |                                  |                                    |   |                                     |                               |

Sources: Leacy (1983) *Historical Statistics of Canada* (Series F91-102) and author’s calculations.

<sup>56</sup> Holcombe and Lacombe (2004, 373).

A broadly similar conclusion can be drawn from the pattern of increase in local effective tax rates as well as in the trend of real per capita local taxes for Ontario. During the late nineteenth century, local governments in Ontario grew into their revenue base, paralleling fiscal development at the provincial level, as described by Drummond (1987). The effective local tax rate did not decline despite increase in the assessment base both in nominal and real terms. This is consistent with demand for revenue across time and continuity in the pressure on municipalities to fund local services. It is only with the shock of the depression and constraints both legal and economic on municipal ability to increase tax efforts that the tendency for effective local tax rates to increase was constrained.

### ***2.5.8 Transfers from the Province of Ontario***

Provincial transfers to municipalities were a small portion of municipal revenues during most of this period. From 1886 to 1910, the principal transfers to municipalities recorded in the financial records were transfers for school purposes and transfers for the administration of justice. Separately, each of these represented from one to one and half percent of the taxes imposed. The latter subsidized the costs of providing county courts.

The principal provincial subsidy to municipalities after the turn of the century was for roads.<sup>57</sup> On township roads, from 1920 to 1924, General Work was subsidized at 20 percent;

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<sup>57</sup> The following describes the development of the cost-sharing arrangements:

“County road subsidies were authorized in 1901 with grants of 33 1/3% in aid of construction only. Simcoe and Wentworth counties received this subsidy in 1903 and the other 35 organized counties were lined up gradually, the last county to receive subsidy being Peterborough for the year 1919. For work done in 1916, the grant on county road construction was raised from 33 1/3% to 40% and grants of 20% in aid of maintenance work were initiated. Included with county roads above are expenditures made during 1918 to 1924 inclusive on Provincial County Roads. The subsidy was 60% for both construction and maintenance. For work done in 1919 the maintenance grant on county roads was raised from 20% to 40%. At the end of 1924 the system of Provincial County Roads was abandoned. In 1925 the County Roads systems were revised and the mileage reduced. All work done in that year on the revised system was subsidized at 50% - the present rate. Work on the old systems was subsidized at 40% for the one year. Ontario (1938c, Book III, Table 29)

superintendence at 40 percent; from 1925 to 1929, these were increased to 30 percent and 50 percent respectively; from 1930 to 1936, the subsidy rate for general work was increased to 40 percent with superintendence remaining at 50 percent. In 1937, the general rate was increased to 50 percent.

After 1927, transfers for local hospital finance (including general hospitals, sanatoria and long-term care for “incurables”) varied between 5 and 12 percent of total transfers, amounting to about \$1.2 million to \$2.3 million annually. After 1930, transfers for social services including relief, mothers’ allowances and old age pensions rose precipitously from \$3.6 million to \$23 million by 1936, with relief accounting for all of the increase.<sup>58</sup> (Table 15).

In 1937, the Province established the so-called “1 mill subsidy” (an unconditional transfer). The total payment amounted to \$2.9 million in that year based on the assessed value of properties. This payment continued during the period under examination. It amounted to 12.8 percent of total provincial transfers.<sup>59</sup>

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<sup>58</sup> The details of municipal expenditures on cost-shared programs and provincial funding are found in Ontario (1938c).

<sup>59</sup> Goldenberg (1939) links the abolition of the municipal income tax to the one mill subsidy and suggests the “subsidy was to be passed on to the taxpayer in the form of a reduction in the tax rate.”

**Table 15 Provincial Transfers, 1920-1937 (Current Dollars)**

|           | <b>Roads</b>   | <b>Health</b>  | <b>Social</b>   | <b>One</b>     | <b>Total</b>   |
|-----------|----------------|----------------|-----------------|----------------|----------------|
|           |                |                | <b>Services</b> | <b>Mill</b>    |                |
|           | <b>\$'000s</b> | <b>\$'000s</b> | <b>\$'000s</b>  | <b>\$'000s</b> | <b>\$'000s</b> |
| 1867-1920 | 23,492.0       |                |                 |                | 23,492.0       |
| 1920      | 5,922.1        |                | 8.5             |                | 5,930.6        |
| 1921      | 8,226.7        |                | 497.1           |                | 8,723.9        |
| 1922      | 8,503.5        |                | 823.6           |                | 9,327.2        |
| 1923      | 7,462.8        |                | 946.2           |                | 8,409.0        |
| 1924      | 7,741.5        |                | 998.7           |                | 8,740.2        |
| 1925      | 8,275.6        |                | 1,042.6         |                | 9,318.2        |
| 1926      | 8,665.2        |                | 1,094.8         |                | 9,759.9        |
| 1927      | 9,659.9        | 1,196.7        | 1,168.0         |                | 12,024.6       |
| 1928      | 11,684.7       | 1,330.3        | 1,269.7         |                | 14,284.6       |
| 1929      | 14,351.3       | 1,562.4        | 1,335.6         |                | 17,249.4       |
| 1930      | 15,060.6       | 1,649.9        | 3,579.3         |                | 20,289.8       |
| 1931      | 16,240.2       | 1,776.5        | 5,616.3         |                | 23,633.0       |
| 1932      | 8,423.9        | 1,919.1        | 9,318.3         |                | 19,661.3       |
| 1933      | 25,440.8       | 1,890.2        | 14,322.4        |                | 41,653.3       |
| 1934      | 11,043.7       | 2,158.5        | 19,100.9        |                | 32,303.1       |
| 1935      | 16,778.7       | 2,250.1        | 24,350.3        |                | 43,379.1       |
| 1936      | 8,606.3        | 2,299.0        | 16,669.5        |                | 27,574.8       |
| 1937      | n/a            | 1,992.0        | 14,562.0        | 2,921          | 19,475.0       |

Source: Ontario (1938, Book III, Appendix and Tables 18-32.)

### *2.5.9 Trends in Municipal and School Debt*

The development of municipal borrowing has been consistently a significant feature of the development of the domestic capital market in Canada.

“For most countries, finding data, even a couple of decades old, on domestic public debt is an exercise in archaeology.” (2009)

“There has been a great tendency to run into debt in all the municipalities of Great Britain, the United States and Canada for some years past. This has been due in part to the rapid growth of cities and towns; partly to the fact that crowded communities have become more alive to the great importance of making sanitary and other improvements; and partly to the greater facility in raising large loans, and the fall in the rate of interest. Even in old English cities large expenditures were found necessary. In the newer American and Canadian cities it was necessary to construct a proper system of sewers, make and pave streets, lay down sidewalks, and carry out improvements for one, or two, or five hundred thousand people all within a few years. In the cities of this continent public works of all kinds cost more than in England, because materials and labour are dearer, and because there is a greater tendency to extravagance and jobbery.

In England the total of all the debts of the “local authorities” amounted in 1874-5 to £92,820,100 and in 1884-5 to £173,207,968. In the United States, in 1870, the debts of all municipalities amounted to \$515,810,000 and in 1880 to \$821,486,447. We have no means of ascertaining what the total indebtedness of the municipalities in Canada is, but the net debenture debt of Toronto, deducting the amount of the sinking fund, at the close of 1886, was \$7,895,708. This was more than six times the whole amount received from taxes in that year, which including the school taxes, was \$1,289,395. The debentures sold amounted in that year to \$668,820. The amount paid as interest was 481,003, nearly two-fifths of the whole amount of the taxes collected. Of this, \$33,207 was paid on bank loans.” (1888)

“Almost with the firing of the last shot in 1918 the pent-up accumulation of demand for public buildings, street railways, highways, and the other expensive facilities of a modern

community burst forth in a flood of provincial and municipal bond issues.”

“many a town went bankrupt during the hard years of the thirties under the burden of debt and other charges light-heartedly assumed during the twenties.” (Perry, 1955)

“It is well known that both cities (referring to Toronto and Hamilton) have borrowed the whole or a large part of the cost of relief for several years past, and will again in 1937.” (1937)<sup>60</sup>

Despite limits (which may have been weak) and despite statutory and administrative hurdles, debt issued by Ontario municipalities for local and school purposes grew steadily through the latter part of the nineteenth century, until the middle of the Great Depression. Twenty years after Confederation, the indebtedness of Ontario municipalities totalled nearly \$30 million in nominal terms and \$25 million in constant 1900 dollars. Of this debt, 22.5 percent had been incurred for assistance to railways. By 1910, the total of gross local debt had increased to \$107.5 million (\$84 million in real terms) (see Figures 19 and 20 below). Of this total, 10 percent was for education purposes and debt incurred to finance assistance to railways had fallen to 3.3 percent.

By the end of the First World War, gross local debt was nearly \$244 million in current dollars and \$94 million in real terms (\$1900), reflecting war-time inflation. By 1924, the gross total debt had reached \$430 million and continued to increase until 1932, peaking at nearly \$505 million in current dollars. At that point in time rural and urban indebtedness reached a plateau and city indebtedness continued to be increased in both current and real terms. By 1941, gross debt outstanding had fallen to \$335 million, approximately the level in the early 1920s. In real

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<sup>60</sup> Reinhart and Rogoff (2009, 101); First Report of the Commission of Municipal Institutions (1888, Sessional Paper (42), 54); Perry (1955, 194-195); Ontario Association of Real Estate Boards (1937).

terms, by 1924, gross local debt had nearly doubled from 1919 to \$191 million and peaked in 1932 at \$306 million. The real value of debt (measured in 1900 purchasing power) also decreased to \$153 million by 1941 (Figures 21 and 22 below).<sup>61</sup>

In the inter-war period, the share of local debt issued for education purposes doubled, having averaged eight percent from 1891 to 1910 and increased to an average of 17.4 percent during the period from 1924 to 1936. This shift in the functional distribution of debt is consistent with increased capital outlays documented in the provincial totals of the financial data of local school boards (Table 45).<sup>62</sup>

From 1924 to 1941, municipal debt can be broken into three categories, general, local improvement and municipal utility debt (Figures 21 and 22). While general debt was secured on the general tax base of a municipality, local improvement debt required the consent of the affected property owners and payment was tied to the affected owners, providing, seemingly, less risk and was perceived as self-financing.<sup>63</sup> Similarly, utility debt was tied to the revenue generating capability of a utility. From 1924 to 1936, local improvement debt accounted for an average of 22.6 percent of gross local debt and increased from \$90 million to 130.6 million in current dollars. The Ontario Association of Real Estate Boards commented that: “Over 60 per

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<sup>61</sup> Cutler and Miller (2006, 173-175) note the attractiveness of municipal issues to investors in the United States in the same period and suggest that that financial innovation and investor interest made it possible for smaller municipalities to expand their borrowing activity.

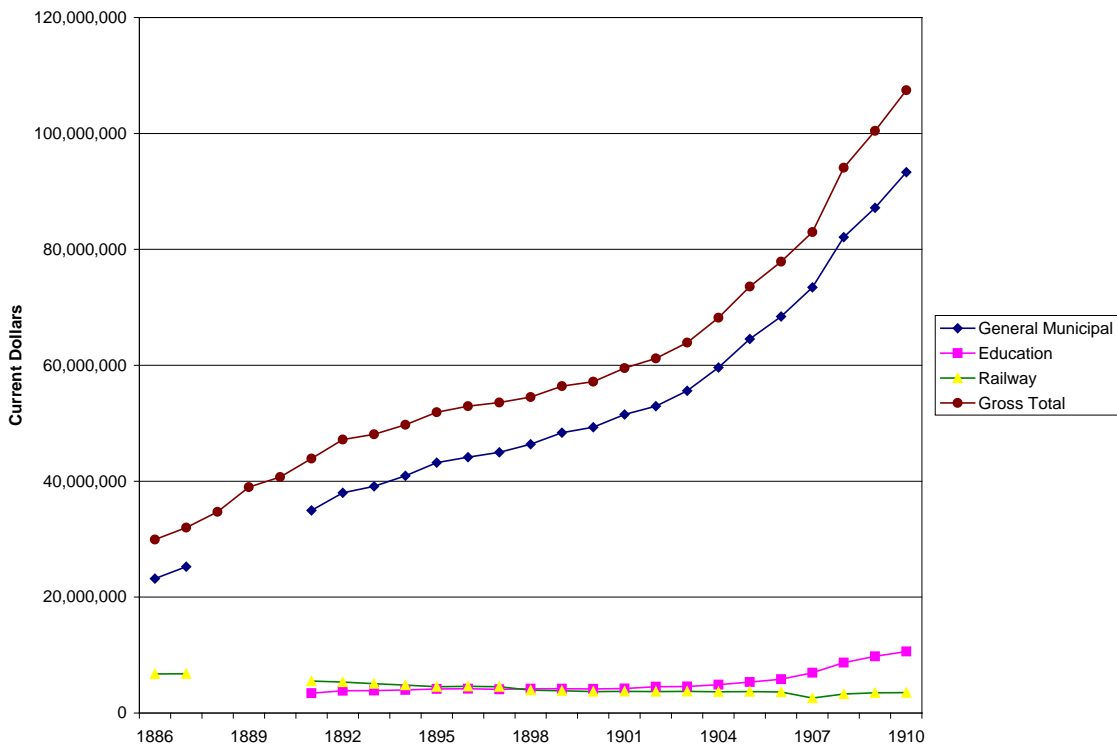
<sup>62</sup> Ontario Department of Education (1938,7) notes debenture indebtedness was related to constructing new secondary schools and had an impact on county levies.

<sup>63</sup> Goldenberg (1939, 35) makes the comment that municipalities may not have had a choice as to whether a local improvement charge on abutting owners could be used. He notes that: “A subsidiary problem of some local importance arises from the old practice, often compulsory under the city’s charter, of charging part or all of such cost against the owners of street frontage, whose property has probably been depreciated in value by the through street and who in any case are not the real beneficiaries of the local “improvement”. Rogers (1971, v.2, 884) makes no mention of any charter responsibilities but makes the point that the courts have upheld local improvement rates as taxes rather than as annual charges and that works for general benefit are not to be specifically assessed. Harris (1996, 151) notes the concerns of Toronto staff over the increase in local improvement debt incurred to finance upgraded infrastructure in areas annexed prior to 1918.

cent of the cost of paving of streets in urban centres has been charged under the *Local Improvement Act* to abutting owners.”<sup>64</sup>

Utility debt accounted for an average of 33 percent of gross local debt, peaking in 1934 at \$157 million. From 1924 to 1930, utility debt actually declined, falling from \$155 million to \$147 million. By the end of the period, consolidation of the various categories of debts in the municipalities under provincial supervision and reduced borrowing reduced local improvement debt to less than \$50 million and utility debt to \$93 million in 1941 (current dollars).

**Figure 19. Local Debt, 1886-1910 (Current Dollars)**

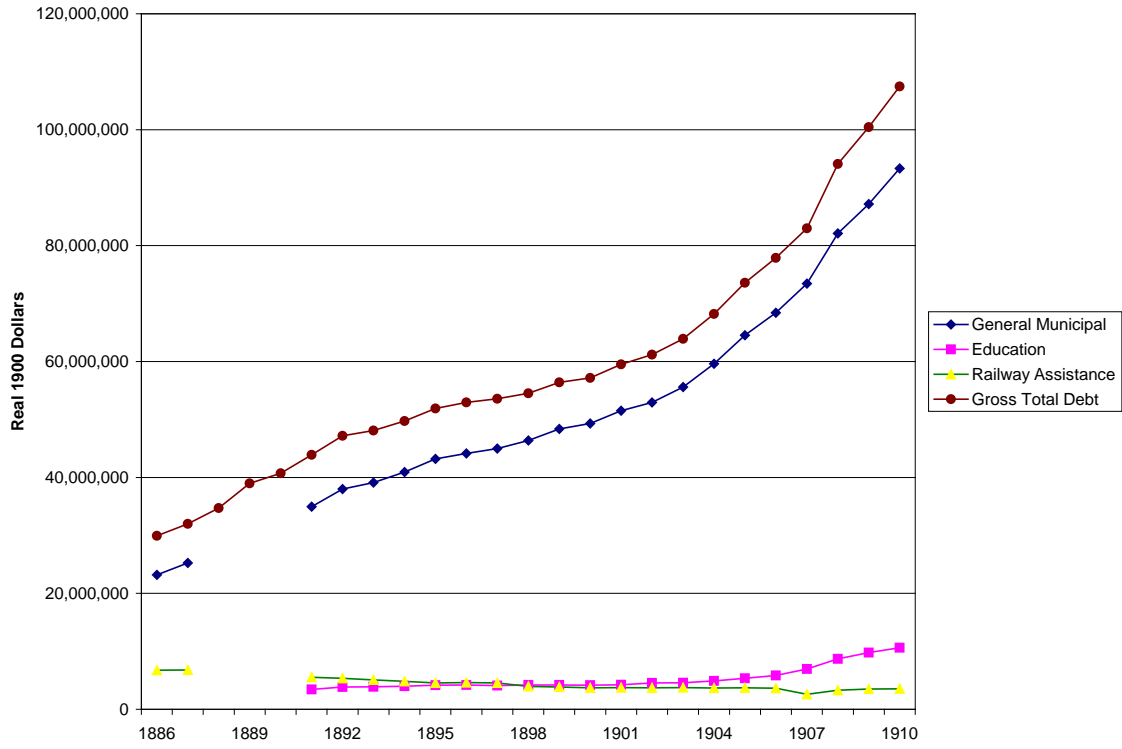


Source: Annual Reports of the Ontario Bureau of Industries.

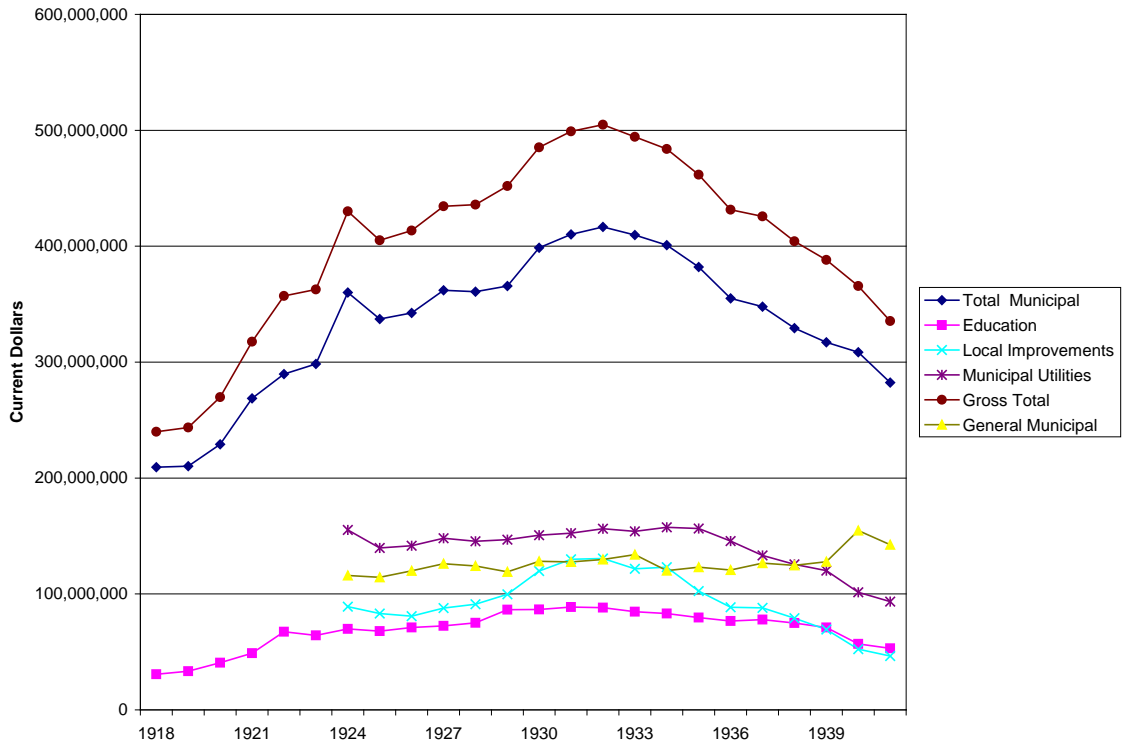
<sup>64</sup> Ontario Association of Real Estate Boards (1937, 20).



**Figure 20. Local Debt, 1886-1910 (\$1900s)**

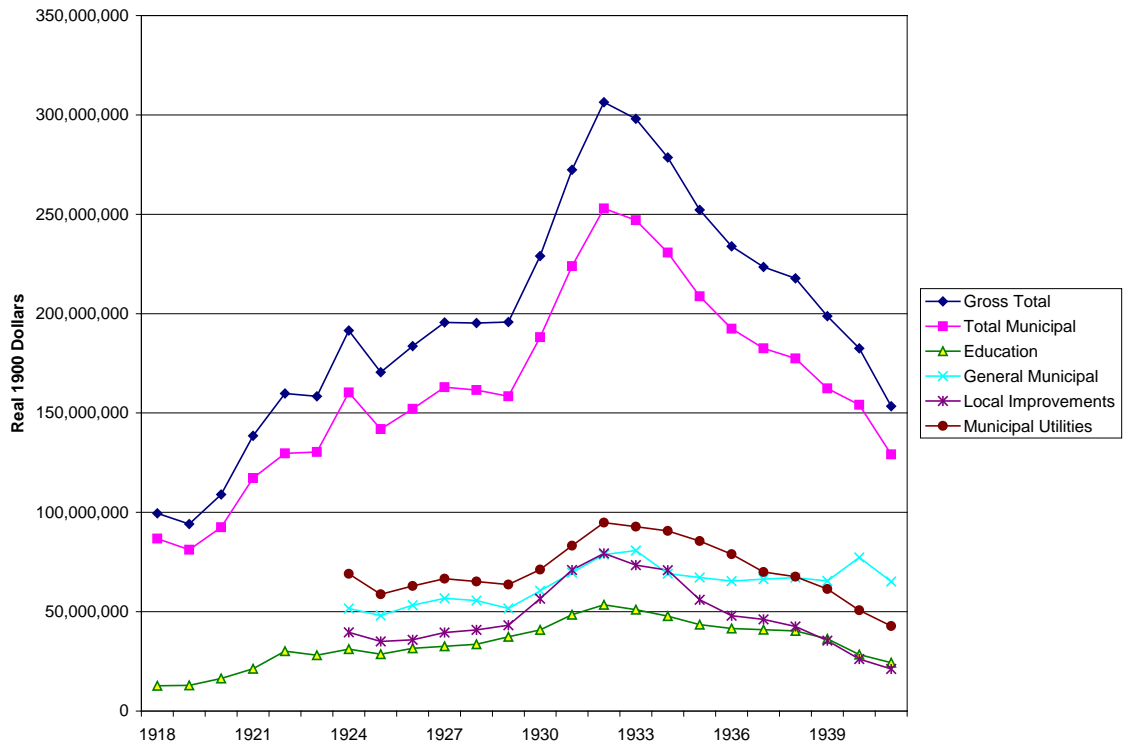


**Figure 21. Local Debt, 1918-1941 (Current Dollars)**



Source: Author's Calculations.

**Figure 22. Local Debt, 1918-1941, (\$1900s)**



Source: Annual Reports of the Department of Municipal Affairs .

### ***2.5.10 The Structure of Local Borrowing***

Table 16 shows the geographic and structural distribution of outstanding local debt from 1913 to 1937 as compiled for the Rowell-Sirois Commission. The patterns are consistent with the data published from the records of the Ministry of Municipal Affairs. While many often ask why municipalities seem reluctant to borrow, reluctance seems to have set in only in the midst of the Great Depression.

In both the suburban areas of Toronto and Windsor, the local municipalities expanded their borrowing activities to finance infrastructure. Much of this debt was ostensibly self-

financing, being issued as utility and local improvement debt. In the eyes of municipal decision makers and in accordance with the accounting standards as well as the legislative provisions of the time, school indebtedness was also viewed as recoverable albeit its recovery was dependent on the municipal ability to collect and remit the taxes that would make the debt recoverable.

**Table 16. Outstanding Debt of Ontario Municipalities**

|                     | <b>1913</b> | <b>1921</b> | <b>1926</b> | <b>1930</b> | <b>1937</b> |
|---------------------|-------------|-------------|-------------|-------------|-------------|
|                     | <b>\$M</b>  | <b>\$M</b>  | <b>\$M</b>  | <b>\$M</b>  | <b>\$M</b>  |
| <b>Metropolitan</b> |             |             |             |             |             |
| <b>Toronto</b>      | 51.1        | 132.8       | 209.0       | 252.3       | 222.7       |
| <b>Windsor</b>      | 1.5         | 11.5        | 26.6        | 38.0        | 35.1        |
| <b>Other Urban</b>  | 70.0        | 126.3       | 155.6       | 182.7       | 163.0       |
| <b>Rural</b>        | 8.8         | 21.4        | 32.3        | 38.7        | 27.1        |
| <b>Total</b>        | 131.3       | 291.9       | 423.5       | 511.7       | 447.9       |

Source: Royal Commission on Dominion-Provincial Relations (1940, V.III,154)

Consequently, the result for many of the suburban municipalities was fiscal crisis, insolvency and provincial supervision. However, that is the subject of the next chapter. Borrowing was, in the main, an urban phenomenon. Thus, throughout the province, outstanding debt peaked during the early 1930s and then was reduced during the latter part of the decade. Table 17 shows the quinquennial average of the ratio of the share of gross local debt relative to the share of population by type of municipality. (A value close to 1 implies congruency in the share of debt and population by type of municipality.) The share of local indebtedness held by cities was three times the share of population until the turn of the century, consistent with the demand for local capital investment, perhaps better access to the capital market and willingness to borrow. The index number falls after 1920 with an upswing in rural borrowing relative to population share. A comparison with the index numbers for taxation relative to population shows that the difference in the share of debt relative to the share of population was significantly

greater than the relative share of tax to population share. (Table 13 above shows the tax relative to population index number.) This difference would also be consistent with a greater emphasis on “pay-as you go” financing in the smaller urban and rural areas of the province. The increase of rural indebtedness at the local level to population share as compared to the relative decline in the cities’ average after 1916 however reflects the extension of infrastructure investment to areas outside urban areas and evidence of increased reliance on borrowing to smooth the acquisition of long-term assets.

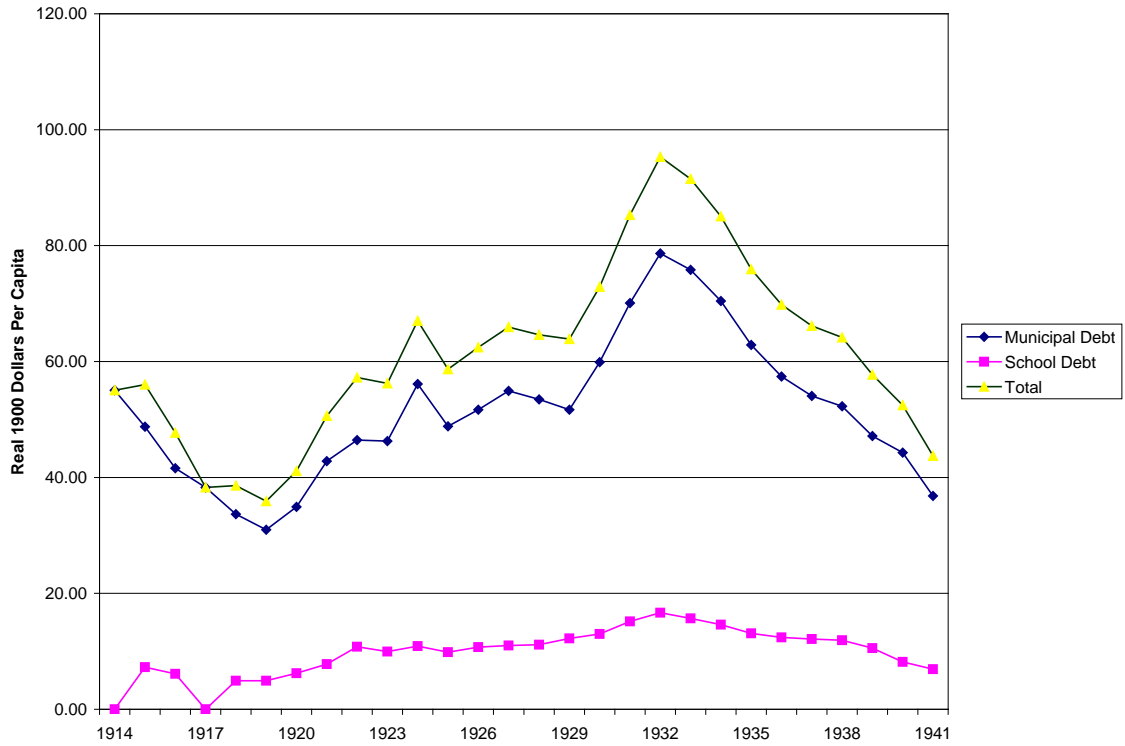
**Table 17. Average Gross Debt Index Relative to Population**

|                | <b>Rural</b> | <b>Urban</b> | <b>Cities</b> |
|----------------|--------------|--------------|---------------|
| <b>1886-90</b> | 0.314        | 0.882        | 3.134         |
| <b>1891-95</b> | 0.201        | 0.956        | 3.038         |
| <b>1896-00</b> | 0.154        | 1.023        | 2.967         |
| <b>1901-05</b> |              |              | 2.694         |
| <b>1906-10</b> |              |              | 2.305         |
| <b>1911-15</b> | 0.152        | 0.710        | 1.331         |
| <b>1916-20</b> | 0.180        | 0.687        | 1.903         |
| <b>1921-25</b> | 0.215        | 0.595        | 1.401         |
| <b>1926-30</b> | 0.371        | 0.797        | 1.596         |
| <b>1931-35</b> | 0.403        | 0.782        | 1.544         |
| <b>1936-41</b> | 0.366        | 0.707        | 1.600         |

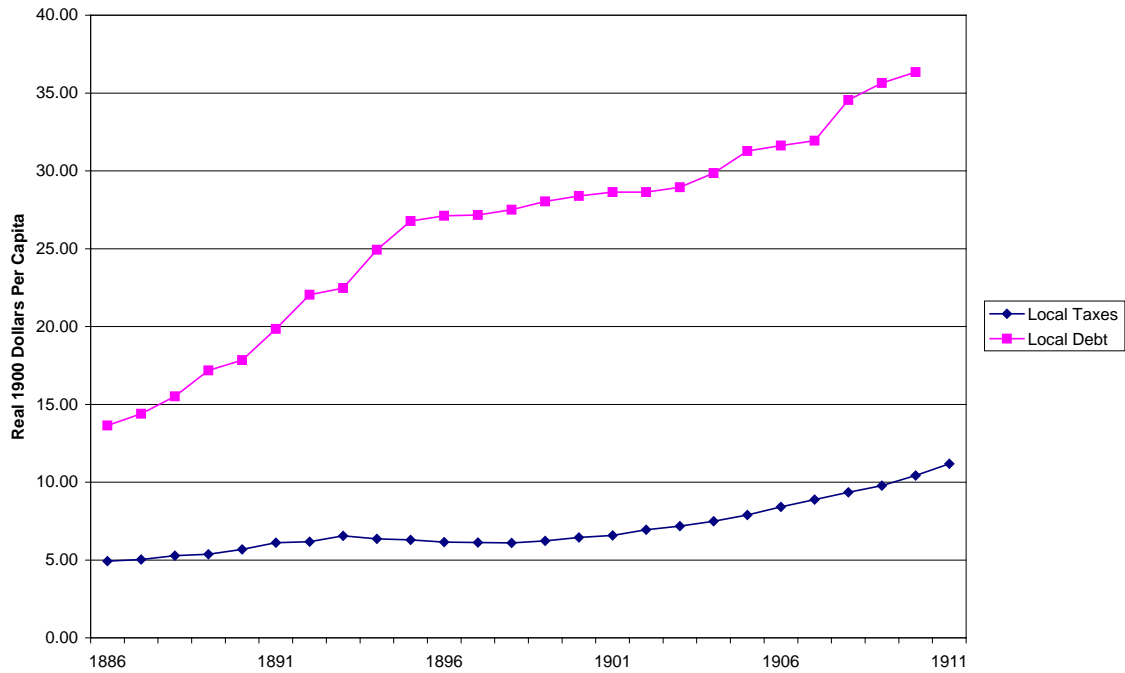
Source: Author’s calculations.

The increase in the nominal and real indebtedness of municipalities that took place during the interwar period is also reflected in the charts of per capita indebtedness (Figures 23 and 24). From 1919 to 1924, per capita debt went from \$36 per capita to \$67 per capita measured in 1900 dollars. During the next five years, the level of real debt per capita remained stable but after 1929, deflation and an increase in the debt incurred locally resulted in a peak in 1932 of \$95 in real debt per capita.

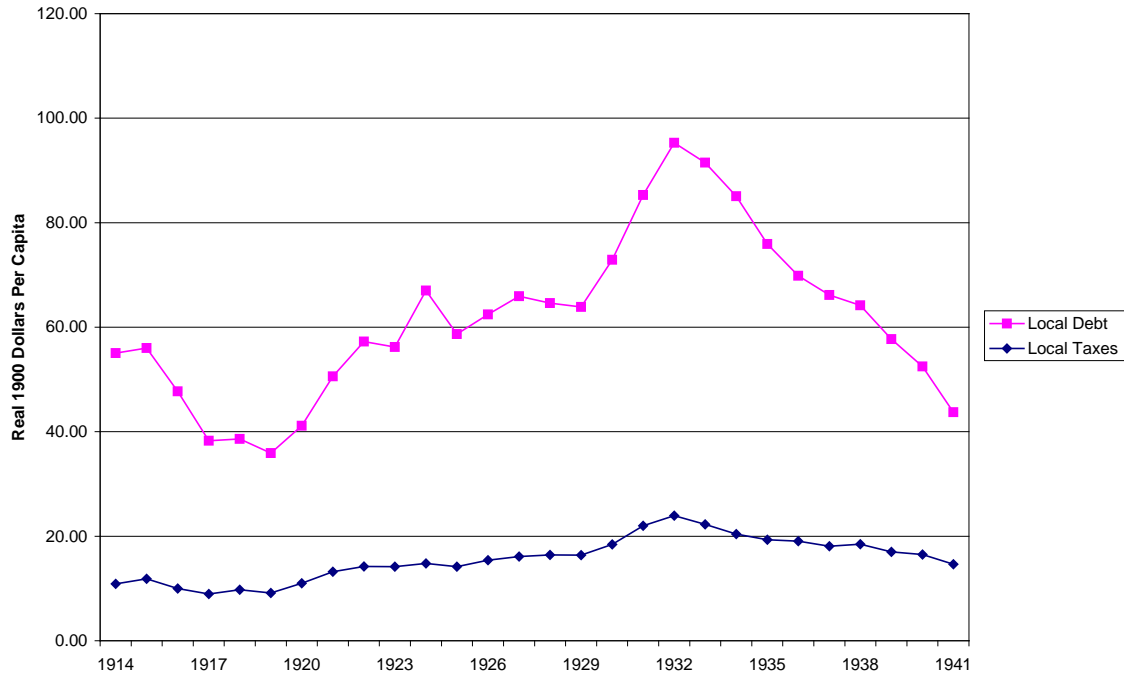
**Figure 23. Real Per Capita Debt, 1914-1941 (\$1900s)**



**Figure 24. Local Taxes and Debt Per Capita, 1886-1911, (\$1900s)**



**Figure 25. Local Tax and Debt Per Capita, 1914-1941, (\$1900s)**



Source: Author's calculations.

Figures 24 and 25 compare the long run trend in real per capita local taxes imposed and gross local debt incurred. As may be seen on the chart, for the period prior to 1914, both debt and taxes doubled in real terms per capita but much of the increase in indebtedness was incurred prior to 1895 while taxes continued to rise but with less drama. In the post war period per capita real taxes exhibit stability while the level of per capita debt rose and fell, seemingly affected by both economic events and institutional response to the crisis of the 1930s, including direct provincial supervision of the financial affairs of municipalities that defaulted on their debts.

Writing in 1790, Alexander Hamilton noted that: “The creation of debt should always be accompanied with the means of extinguishment.”<sup>65</sup> The following table shows the average of the annual ratios of gross local debts to taxes imposed by municipalities (data permitting). Up to 1918, this indicator suggests that local debt was increasing relative to taxes imposed; from 1919 to 1923, taxation increased relative to the debt outstanding.<sup>66</sup> While the mid-twenties witnessed a reversal again, the depression ushered in an era of debt reduction and relative tax increase.

**Table 18. Average of the Annual Ratios of Gross Local Debt/Taxes Imposed**

|           |      |           |      |
|-----------|------|-----------|------|
| 1886-1890 | 3.56 | 1919-1923 | 3.90 |
| 1891-1895 | 3.96 | 1924-1928 | 4.15 |
| 1896-1900 | 4.42 | 1929-1933 | 3.96 |
| 1901-1905 | 4.39 | 1934-1938 | 3.78 |
| 1906-1910 | 4.41 | 1939-1941 | 3.19 |
| 1914-1918 | 4.56 |           |      |

Source: Author’s calculations.

The following table shows the quinquennial average for the ratio of the share of gross local debt relative to the share of local taxes. (A value close to 1 implies congruency in the share of debt and taxes.) Again, cities accounted for a greater share of the local indebtedness in the province relative to the share of taxation. A comparison with the index numbers for taxation relative to population shows that the gap in the share of debt relative to tax was smaller than the relative share of debt to population share. This is suggestive of a relationship between the ability to borrow and to tax. Thus, the willingness or the necessity to acquire long-term obligations was closely linked to the (perceived) capacity to raise the taxes to repay the obligations.

<sup>65</sup> As noted in Rodden (2006, 75) from “Report Relative to a Provision for the Support of Public Credit”, New York, January 9, 1790. As noted, the legislation of the 1870s and 1880s attempted to follow this advice.

<sup>66</sup> In 1934/35, the unweighted mean ratios of debt-expenditures were 2.32 and 3.30 in rural and urban municipalities in Norway. (Falch and Tovmo (2003, 133).

**Table 19. Average Gross Debt Relative to Taxes Imposed**

|                | <b>Rural</b> | <b>Urban</b> | <b>Cities</b> |
|----------------|--------------|--------------|---------------|
| <b>1886-90</b> | 0.419        | 0.877        | 1.811         |
| <b>1891-95</b> | 0.307        | 0.942        | 1.643         |
| <b>1896-00</b> | 0.239        | 0.962        | 1.665         |
| <b>1901-05</b> |              |              | 1.635         |
| <b>1906-10</b> |              |              | 1.577         |
| <b>1911-15</b> | 0.231        | 0.939        | 1.030         |
| <b>1916-20</b> | 0.265        | 0.910        | 1.361         |
| <b>1921-25</b> | 0.307        | 0.715        | 1.054         |
| <b>1926-30</b> | 0.505        | 0.950        | 1.243         |
| <b>1931-35</b> | 0.632        | 0.921        | 1.155         |
| <b>1936-41</b> | 0.571        | 0.856        | 1.190         |

Source: Author's calculations.

The municipal willingness to borrow during the period prior to the Great Depression would seem to be an affirmation of the Wallis and Weingast (2005) contention that variations of “tax-less” finance and benefit taxation make high levels of borrowing acceptable to voters (ratepayers). Much of the debt incurred was seemingly secured by utility fees (tax-less finance) or by local improvement taxes and recoverable school taxes (benefit taxation). It was only when owners walked away from the properties upon which local improvement assessments were secured and school taxes became uncollectible (as did municipal taxes) that the flaw in this perception became apparent. By the end of the 1930s, municipal indebtedness was on a downward track even as the level of taxes imposed remained relatively stable.

The next section provides an introductory overview of education finance over the long run. This is perhaps the most intertwined area of provincial-local finance with implications for both taxation and indebtedness at the local level.

## ***2.7 Conclusions***

Municipalities in Ontario taxed, borrowed and spent. From 1886 to the 1930s, in aggregate, they were the level of government with the most impact on the pocketbooks of taxpayers and voters. During this period, the provincial population became urbanized, developed



the contours of its existing urban form and its general economy. Infrastructure was put in place that still serves today.

During this period, as well, the legislative framework and the institutional form created in the middle of the nineteenth century continued to be expanded and revised in response to challenges posed by economic circumstance. The municipal revenue base was narrowed by provincial fiat, with the removal of access to the income tax base, although spending responsibilities were not. While published expenditure data is incomplete, the data that is available shows the increasing levels of municipal expenditures particularly in cities by comparison to rural and smaller urban municipalities. The data for nominal and real expenditures and local taxation show a peaking in the early 1930s around the time of the worst period of the Great Depression. Taxes per capita, as a portion of real income and of assessed values similarly reached their peak at the nadir of average personal income and the depression. By the mid 1930s, the constraints, both economic and legal, on municipal ability to generate revenues became binding.

The evidence suggests that the municipal tax base reached a capacity constraint in the 1930s as effective tax rates stabilized. At the same time, there was no apparent slowdown in borrowing until the midst of the Great Depression. However, ultimately, as the Rowell-Sirois Report commented:

“the outstanding feature of the Ontario revenue system is the high yield, both proportionately and absolutely, of real property taxation. This particular source has long been the backbone of Ontario public finance as might be expected from the highly urbanized character of the economy.”<sup>67</sup>

Aggregate data thus show that Ontario municipalities grew into their spending responsibilities, exploiting the local tax base made available to them through the tax assignment

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<sup>67</sup> RCDPR(1940, v.1, 230).

process. Municipalities and financial institutions interacted creatively to develop appropriate borrowing instruments. However, the generally upward trend in taxing, borrowing and spending was reversed by the onset of the Great Depression. The next two chapters rely on disaggregated data to further examine the provincial-local relationship during this “defining moment”.

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