RMA
RURAL MUNICIPALITIES *of* ALBERTA

The MacKinnon Report: Many Questions, Few Answers

RMA Member Resource

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Introduction

Governments are often judged based on revenues and expenses. Often voters, the media, and even governments themselves forget that their role is to provide public services and infrastructure. As such, spending can only be evaluated in the context of a government's responsibilities and the types and quality of services they provide. This challenge exists in every level of government in different ways.

Municipalities face this challenge with their own residents and taxpayers, but also in their relationship with provincial and federal governments, which often provide municipalities with a large portion of their revenues in the form of grants. Although those grants are used to support crucial local infrastructure and services such as roads, recreation centres, water and wastewater systems, and others, they are often viewed as just another provincial or federal expense to be restricted, reduced, or cut altogether on a path back to balance.

In 2019, Premier Kenney fulfilled a UCP party platform election promise when he appointed an independent panel of experts to review Alberta's finances and economy. The panel was officially known as the *"Blue Ribbon Panel on Alberta's Finances,"* but was more commonly referred to as the MacKinnon Panel, after Chair Janice MacKinnon, former Saskatchewan Finance Minister.

Within the panel's findings was a section on municipal spending and provincial funding of municipalities. In both sections, the panel indicated that municipalities were financially problematic. According to the panel, Alberta's municipalities had too much capital stock (AKA infrastructure) compared to municipalities in other provinces and received too much funding from the province compared to municipalities elsewhere in Canada.

This resource is intended to be used by RMA members to better understand the municipally-related recommendations made in the MacKinnon Report, and more importantly to critique the questionable data and assumptions that led to the panel's conclusions that municipalities have too much infrastructure and are over-funded by the province. As the recommendations could be used by the Government of Alberta to justify further downloads onto municipalities or to reduce provincial grant funding, it is important that members understand the panel's recommendations and the flawed analysis that led to them.

Municipalities in the MacKinnon Report

The MacKinnon report focused on many areas of provincial jurisdiction, from education to healthcare to public sector compensation, and, of course, municipalities. The panel concluded that "there is an ongoing structural imbalance between revenues and expenses in the Alberta government that represents a serious threat to the financial health of the province. Due to the fundamental changes that have taken place in energy markets over the past decade, today's fiscal crisis is arguably far worse than faced by the Alberta government in the early 1990s."

Pretty serious stuff. Based on this excerpt from the panel's report, it sounds like the province is fiscally broken and serious solutions are needed. In fact, the report continues on to say that "cuts around the edges won't get Alberta back to a sustainable balanced budget. The government needs to make a difficult but necessary fiscal course correction immediately to return the province to fiscal health over the medium to long term."

Let's zoom in on the panel's view of municipal finances and the course corrections needed to get municipalities back on track. From among the panel's 26 recommendations, only two focused specifically on municipalities.

The MacKinnon Report's analysis actually combines provincial and municipal capital spending, and introduces the section with the following:

Government net capital stock per capita, both provincial and municipal, has been consistently above the 10-province average, especially in the last decade. In 2017, the provincial government's net capital stock per capita was 19% above the 10-province average and the municipal governments' stock was 81% above the average, bringing the combined provincial-municipal measure to 44% above the national average.

Based on the high levels of capital stock per capita in Alberta compared to other jurisdictions, the MacKinnon Report included two recommendations directly linked to capital stock. Recommendation 13 states the following:

> *Bring Alberta's net public capital stock in line with the average per capita capital stock in the other provinces over the next ten years as part of its balanced budget plans and long-term fiscal sustainability.*

While doing so would require big changes for both the province and municipalities, the panel's analysis frames municipal capital stock (which is never defined in the report) as much more out of whack with comparators than provincial levels (81% compared to 19%).

Recommendation 15 states the following:

The Government of Alberta should examine its legislative framework for capital funding to municipalities with the goals of:

- *Aligning funding to provincial goals and priorities and fiscal capacity, while further considering funding formulas that require municipalities to share more in the costs of major projects.*
- *Adjusting its allocation formula for grants to municipalities in line with the policy of bringing Alberta's provincial and municipal per capita capital stock in line with the comparator provinces.*
- *Establishing accountability mechanisms and performance measures to monitor the delivery of municipal programs and services and value for money spent, so citizens have the ability to constructively evaluate their local government and their use of tax dollars.*

- *Making better use of federal infrastructure funding, though the Investing in Canada Infrastructure Program (ICIP) as a means of more effectively managing the costs of the Capital Plan.*

Okay, recommendation 15 definitely places a lot of focus on municipalities! Let's unpack some of this.

The panel wants to:

- Shift a larger portion of the costs of grant-funded projects onto municipalities.
- Change how grants are funded to reduce the amount of capital stock per capita in municipalities.
- Increase oversight and measurement of how municipalities spend their money and introduce definitions of value for money.
- Shift more federal funding away from municipalities and into provincial projects identified through the province's capital plan.

Those are serious changes that could drastically impact municipal sustainability. But if the financial performance of municipalities is really as concerning as the panel makes it out to be, maybe they're necessary. With that in mind, the next step is to look at the data and assumptions that the panel used to support their recommendations to better understand whether they are valid.

Capital stock: What the heck is it?

If you read through the section above, or better yet, the section of the panel's report focused on municipalities, you'll find a certain term popping up repeatedly: ***"capital stock per capita."*** The panel's recommendations are based on the idea that Alberta provincial and (especially) municipal capital stock per capita is way higher than in other provinces, which is a sign of overspending. Fair enough I guess, but what is capital stock?

That seems like a fair question, but it is one without an answer in the report. Tracing the report's footnotes takes readers on a magical journey through Statistics Canada data, but no path on that journey provides a definition of capital stock. Now, we can use common sense to assume that the term refers to the capital assets owned by provincial or municipal governments; it probably includes buildings, equipment, vehicles, pipes, and roads. I wonder if it also includes smaller things like office equipment, or much larger things like land. The short answer is, "who knows?" Maybe the panel does, but if so, they have not shared that information with readers, making it very difficult to understand exactly what assets the panel is including in their analysis that paints Alberta municipalities as over-spending outliers.

Even though we can't provide a definition for sure, we can look at some other common ways capital stock is defined and used. First off, capital stock appears to be an accounting term and it is used often by Statistics Canada. One of the most detailed definitions of capital stock is in a 2003 Statistics Canada report titled *Public infrastructure in Canada: Where do we stand?*.

It is a long definition, so we've pulled out some key points:

- *Capital stock is a measure of the amount of capital in existence at a particular point of time, e.g. December 31, 2002.*
- *An asset must be durable to be classified as capital. The convention is that any asset expected to be in service for at least one year is categorized as capital, if an asset is expected to be in service for less than one year it is categorized as a consumption good. Exceptions to this rule exist. For example, consumer durables, such as cars and refrigerators, are classified as consumption in the Canadian System of National Accounts, but are treated as capital in the construction of the Canadian Balance Sheet Accounts and the capital input employed in the Canadian Productivity Accounts[...]Estimates of Canadian public capital stock include fixed tangible assets and intangibles such as software capital. Fixed assets are non-financial produced assets which are used in a production process. Fixed tangible assets are best defined by example as the adjective "tangible" is not sufficiently definitive. Tangible assets include dwellings, other buildings and structures, machinery and equipment.*

Confused yet? If you work in finance, probably not. Otherwise… maybe. The main takeaway from this definition is that capital stock must be durable (with some exceptions), and it can include both tangible and intangible assets, and that consistently defining tangible assets usually doesn't work, so examples are needed.

Because capital stock is a complex and sector-specific term (remember it relies on examples, so what counts as "capital stock" in a municipality might be completely different than in something like the mining industry), it is mainly used in academics and policy literature, and less in "on the ground" scenarios. Research on public sector capital stock is usually focused on analyzing possible links between public sector capital investment and private sector growth. This research is difficult to draw conclusions from because of different definitions of capital stock and different measures for private sector growth. What is important to keep in mind is that capital stock mainly lives in the academic and policy world.

Capital stock per capita: Yeesh, that sounds even more complicated

If capital stock is not part of the language normally used by provincial and municipal decision-makers, then why would the panel use it? It is not defined, not well understood, and becomes even more confusing when digging into its origins. Well, the term has been used in some recent Alberta policy debates, most notably between David Dodge and Melville McMillan. First off, who are these people? David Dodge is the former Governor of the Bank of Canada, who authored the Dodge Report on behalf of the Government of Alberta and in conjunction with the 2015 Alberta Budget. The report used capital stock measured against GDP to argue that "real economic activity per capita is far more intense in Alberta than in the other provinces and public capital has not kept pace with this activity to the same extent as in the other provinces over the last 20 years." In other words, Dodge used the metric to argue that Alberta's capital spending lagged given the intensity of its economic activity.

Melville McMillan is a Professor Emeritus at the University of Alberta, but has written multiple articles for the University of Calgary School of Public Policy, an institution with ties to two of the MacKinnon panel members: Chair Janice MacKinnon and panel member Bev Dahlby. McMillan's use of capital stock per capita has mainly been in opposition to the conclusions of the Dodge Report. In his first rebuttal, written in 2015, McMillan argues that when capital stock **per capita** measures are used (as opposed to Dodge's comparison of capital stock to GDP), Alberta's capital stock spending is much higher than the comparator provinces in the Dodge Report. McMillan opposes Dodge's use of GDP, arguing that economic activity in Alberta (and Saskatchewan to a lesser extent) is unique from that in other provinces, so GDP is an inaccurate comparator.

McMillan makes similar arguments in a 2019 article. Still focused on Dodge's 2015 report, McMillan continues to argue against the use of GDP as a metric for measuring the value of capital investments.

He states that:

Using GDP as the benchmark for necessary infrastructure suggests that a more productive worker requires more roads, highways, bridges, water-treatment, and so forth, than a less productive worker, which is questionable. A seemingly more appropriate way to assess the need for infrastructure would be based on population and population growth, so on a per capita basis.

Many of you reading this are councillors representing rural municipalities, and you would likely disagree with McMillan's argument that certain types of economic activity do not require more capital investment than others, given the massive infrastructure networks in your sparsely populated municipalities that exist mainly to support the oil and gas, forestry, or agriculture industries. However, in an academic context, McMillan's arguments are completely valid and available for critique by anyone willing to take a different perspective.

However, where McMillan's arguments for capital stock per capita measures are not valid is in their role in driving the very serious recommendations found in the MacKinnon Report. Not only is capital stock not defined, but there is no explanation of why per capita is the proper unit for such a measure, and no mention that a completely different metric (GDP) was used by government to evaluate capital spending very recently, and it produced strikingly different results.

At the risk of sounding cynical, it is possible that capital stock per capita was used by the panel for two reasons:

1. The panelists familiarity with, and likely support for, McMillan's work, and;

2. The fact that McMillan's work tells the general story that the panel was seeking: current spending is too high and reductions are necessary.

Unfortunately, there is no way to know this for sure based on the information provided in the report, but some research on the normal use of capital stock and its history in Alberta suggests that it was chosen for a reason.

The numbers don't lie (or do they?)

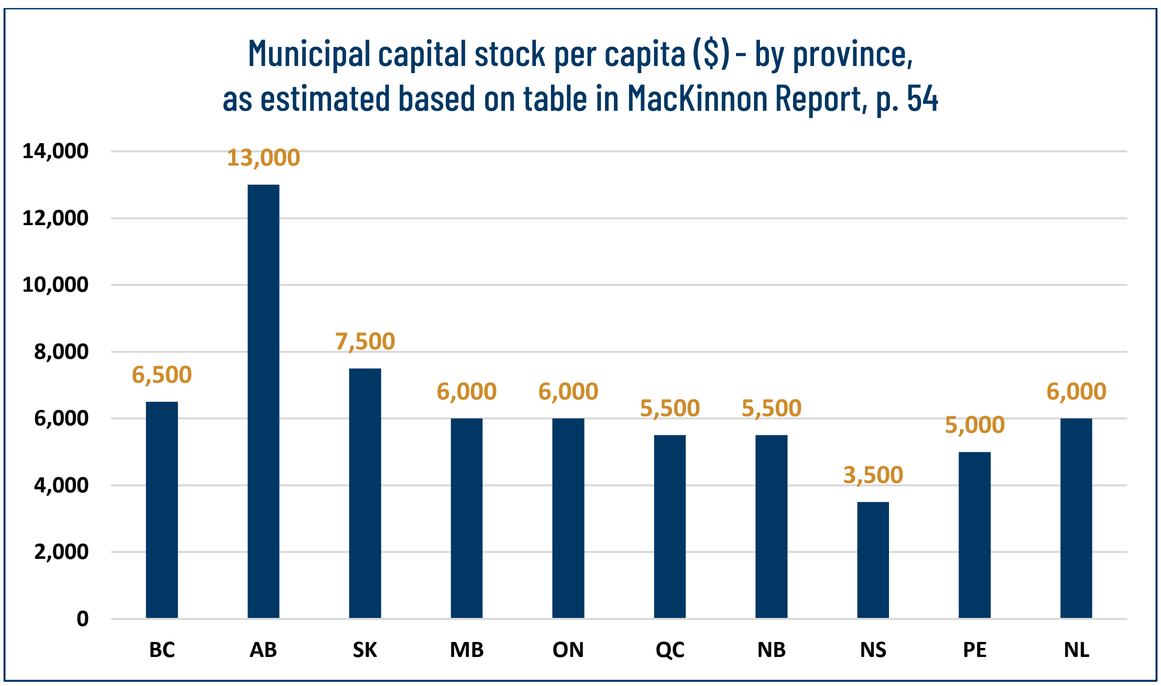
Setting aside the fact that capital stock seems like an odd metric to evaluate municipal financial performance and the peculiar history of capital stock per capita within Alberta, it is worth diving into the actual data used by that panel to inform their recommendations. Even if capital stock per capita is not the perfect metric to use, the panel's conclusion that net municipal government capital stock per capita in Alberta is 81% above the national average is alarming and deserves attention to understand what this means, and why Alberta is such an outlier.

About that data...

Before getting into specifics, let's step back for a second and really think about what *"municipal capital stock per capita"* means (ignoring the fact that we don't know exactly what counts as capital stock). As far as we know, the term measures how much money a municipality spends on its capital assets per person. If Alberta's municipal capital stock per capita is 81% above average, this means that if the average municipality in Canada spends $1.00 per person on capital stock, a municipality in Alberta spends $1.81 per person. This sounds powerful, but what does it mean?

To consider this question, let's poke around the data used by the panel. Unfortunately, the specific data used to generate the municipal capital stock per capita figures used for each province in the table on page 54 is not available, so we have no choice but to estimate the per capita amounts used in the table. Admittedly this is not the most scientific approach, but we can only work with the hand (and data) we were dealt! The amounts look something like this:

Chart 1.0



As a first step, let's reverse-engineer these per capita amounts to try to figure out how much actual municipal capital stock each province has based on the panel's data. This is as simple as doing some quick math using the figures in the table above combined with the most recent Statistics Canada population data for each province.

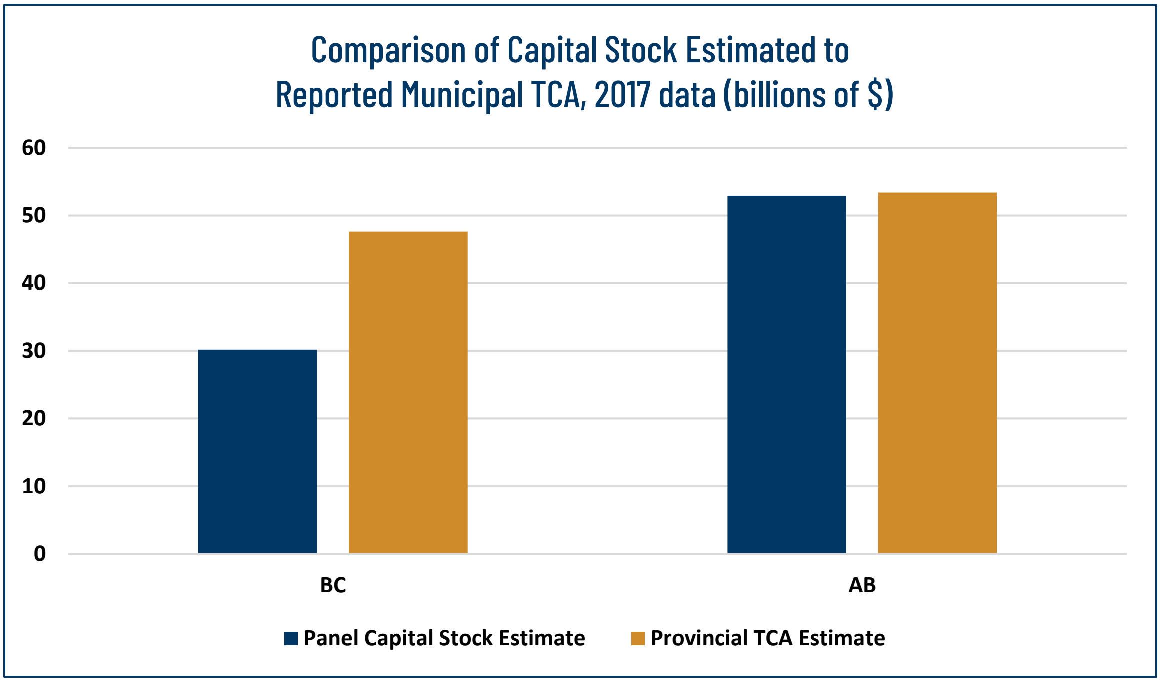
Note that because these are rough estimates, we included an upper and lower sensitivity analysis to provide a likely range of actual capital stock.

Table 1.0

PROVINCE	MUNICIPAL CAPITAL STOCK PER CAPITA (ESTIMATE BASED ON PAGE 54 TABLE)	POPULATION (2016)	ESTIMATED TOTAL MUNICIPAL CAPITAL STOCK	LOWER SENSITIVITY ANALYSIS (3%)	UPPER SENSITIVITY ANALYSIS (3%)
BC	$6,500	4,648,055	$30,212,357,500	$29,305,986,775	$31,118,728,225
AB	$13,000	4,067,175	$52,873,275,000	$51,287,076,750	$54,459,473,250
SK	$7,500	1,098,352	$8,237,640,000	$7,990,510,800	$8,484,769,200
MB	$6,000	1,278,365	$7,670,190,000	$7,440,084,300	$7,900,295,700
ON	$6,000	13,448,494	$80,690,964,000	$78,270,235,080	$83,111,692,920
QC	$5,500	8,164,361	$44,903,985,500	$43,556,865,935	$46,251,105,065
NB	$5,500	747,101	$4,109,055,500	$3,985,783,835	$4,232,327,165
NS	$3,500	923,598	$3,232,593,000	$3,135,615,210	$3,329,570,790
PE	$5,000	142,907	$714,535,000	$693,098,950	$735,971,050
NL	$6,000	519,716	$3,118,296,000	$3,024,747,120	$3,211,844,880

Okay, now we're getting somewhere. Before we look at the pros and cons of a per capita approach, let's consider how accurate our estimated total capital stock amounts are. While there is no easy way to do this, one approach is to compare some of the numbers above to provincial data on tangible capital assets (TCA). As the panel has used 2017 data, we have pulled 2017 provincial reporting on municipal TCA from two provinces for comparison.

Chart 1.1



Clearly, while the panel's estimates of capital stock in Alberta align quite closely to actual reported TCA based on Alberta Municipal Affairs data for 2017, the figures the panel uses for British Columbia are much different than that reported in the Province of British Columbia's municipal non-financial assets for 2017. This could be for many reasons, including inconsistencies in the type of assets that each province and Statistics Canada include in their respective measures, but it is fair to argue that this makes the panel's conclusions difficult to take seriously, and points to the danger of making policy recommendations based on over-simplified provincial comparisons. Using provincial asset data would result in British Columbia municipalities having a per capita asset level of over $10,000, which is much closer to Alberta's figure than the current estimate. Provincial data in this area is difficult to access, but the inconsistency in British Columbia's information suggests that the data used by the panel is not necessarily aligned with actual provincial reporting.

People, places, and things

It is fair to say that the data used by the panel is at worst inaccurate, and at best, not clearly explained. This is crucial and casts doubt on the strength of its claim that Alberta's capital stock per capita spending is 81% above average. However, for the sake of further considering the panel's arguments, let's assume this is accurate and return to the question at the beginning of this section: what does this mean, and why does it matter?

Using capital stock per capita as the only measure of municipal spending relies on two assumptions:

1. People are the only driver of municipal service and infrastructure needs.

2. Delivering services and building infrastructure for people should cost about the same no matter where it's happening.

Keep in mind the quote from Melville McMillan's work advocating for the use of capital stock per capita, as it sums these assumptions up well, although in relation to workers rather than general infrastructure and service users:

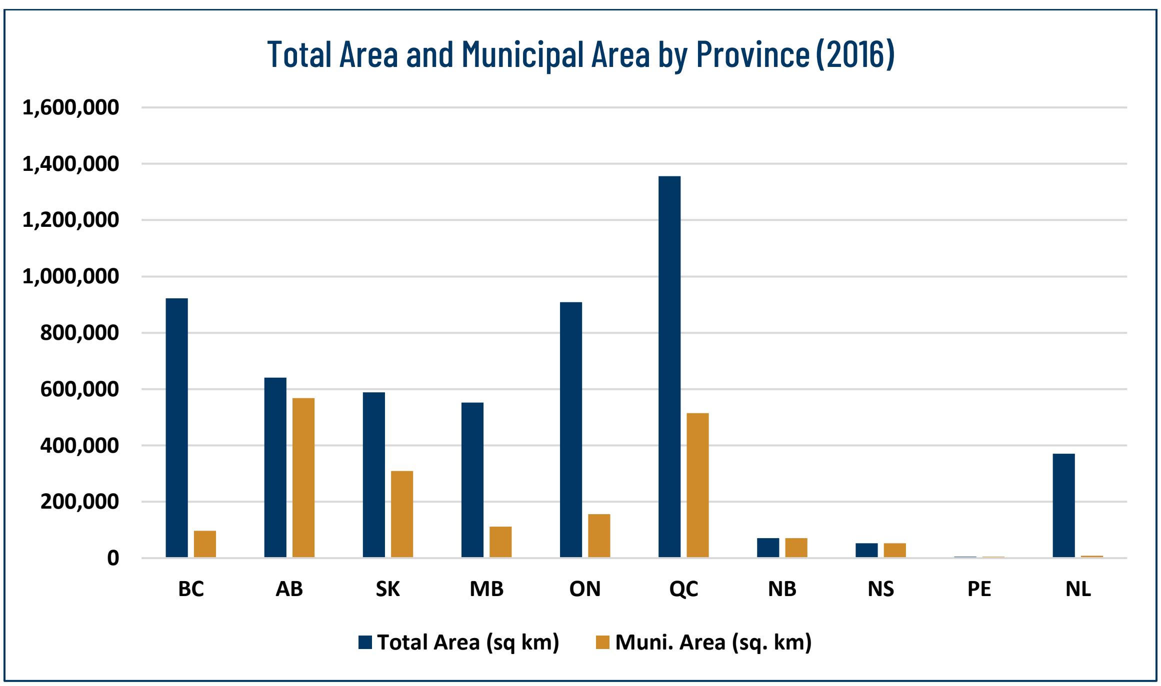
"Using GDP as the benchmark for necessary infrastructure suggests that a more productive worker requires more roads, highways, bridges, water-treatment, and so forth, than a less productive worker, which is questionable."

The assumption of capital stock per capita is that municipalities should spend the same amount on everyone, no matter what. Whether you live in downtown Toronto, the lower mainland of British Columbia, or the MD of Opportunity, the costs that your municipality incurs to deliver services to you should be relatively equal. Much like McMillan assumes that all workers, regardless of their productivity, require similar amounts of infrastructure, the panel assumes all individuals require similar amounts as well, or at least that the costs of providing it should be similar.

What this assumption excludes is where these municipalities exist, the role of municipalities in different provinces, and non-residential users of municipal infrastructure. In most provinces in Canada, municipalities are present only in the most populated areas, while in more isolated and northern areas, services and infrastructure are provided directly by provincial governments or through regional bodies. The exception to that rule is in the maritime provinces and in Alberta. While the maritime provinces are quite small and unique in their own right, Alberta is an outlier among all other provinces in terms of the role of municipalities in providing services to large and sparsely populated areas.

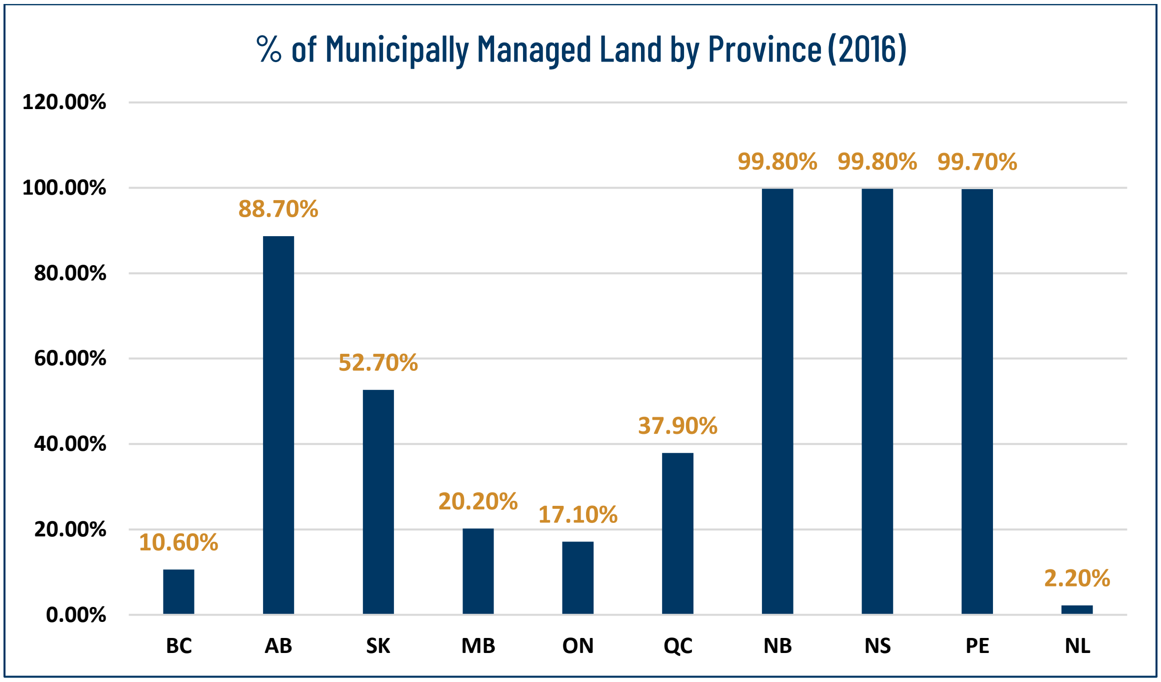
To illustrate, let's look at the overall area and municipal area of each province.

Chart 1.2



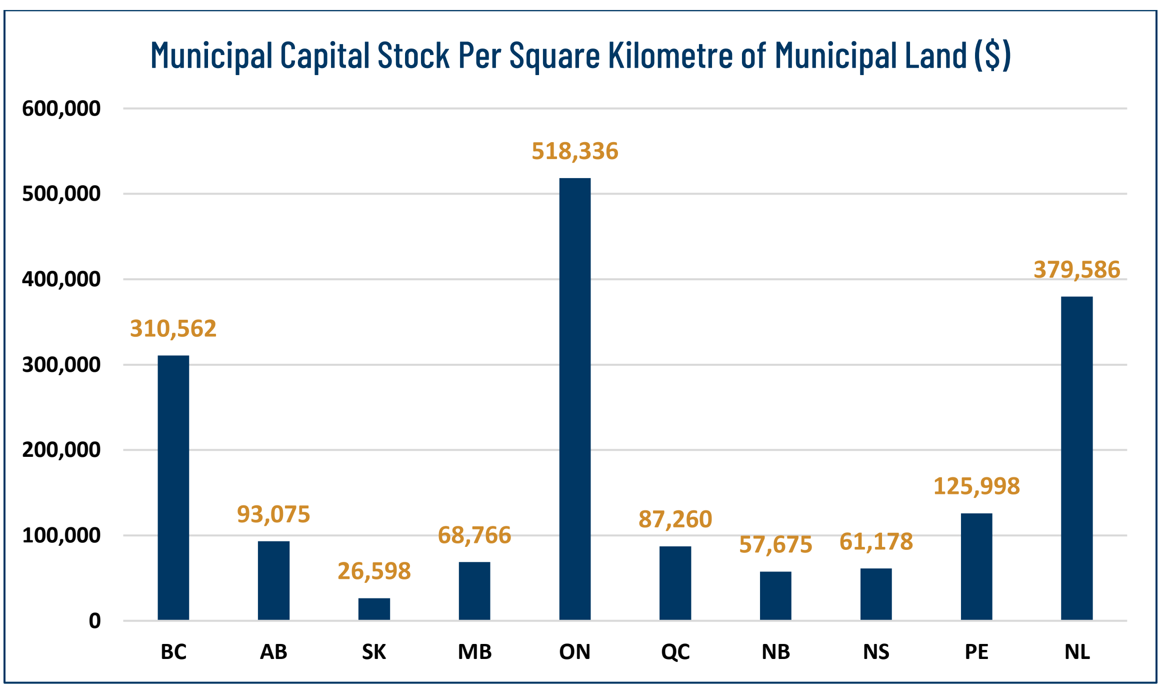
Municipalities in Alberta cover more land than in any other Canadian province, including Ontario and Quebec, both of which are much larger overall. The table below examines this in another way by comparing the portion of land managed by municipalities in each province.

Chart 1.3



This is interesting and is certainly something not considered by the panel, but much like the per capita data, it is fair to wonder what it means and why it matters. To get at this question, let's borrow some of the panel's data to compare municipal capital stock amounts to municipally managed land in each province.

Chart 1.4



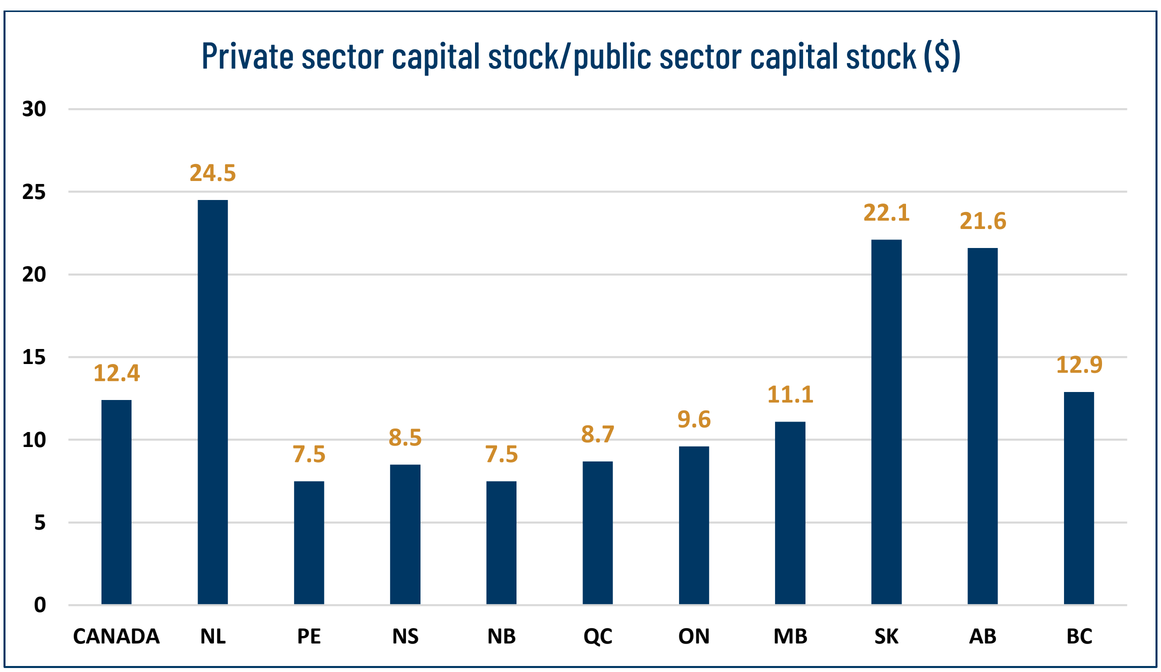
Clearly, comparing municipal capital stock by land mass drastically changes the conversation. In this model, Alberta is in the middle of the pack in terms of capital stock, and far below the three provinces that appear as outliers. This does not mean that land mass is the right metric for comparisons, but it does mean that per capita is also wrong, and a meaningful measure likely relies on a combination of the two, as well as others. If municipalities in Alberta are providing infrastructure and services to 78% more of the land mass than in British Columbia, 71% more than in Ontario, and 51% more than those in Quebec, then of course their per capita costs will be higher, as the land that is municipally managed in Alberta but not in other provinces consists of very dispersed populations and high levels of industrial activity. This means that a municipal road in rural Alberta may only be used by a single household (or none at all) but provides a crucial point of access to natural resources used by the oil and gas or forestry industry. The benefit of this municipal road is not reflected in per capita measures.

Public sector capital stock: It exists for a reason!

While it's easy enough to determine that a per capita approach does not consider the value that municipal infrastructure provides in Alberta that may not be replicated elsewhere, it leads to another question: how do you measure that? There is no perfect way, but fortunately Statistics Canada maintains information on private sector capital stock per capita which allows for an interesting comparison of the link between spending on public infrastructure and private sector investment. As the panel's report points out, Alberta's public sector capital stock spending is highest in Canada. What the report does not mention, however, is that the province also features extremely high levels of private sector capital stock, likely due to the importance of capital-intensive industries such as oil and gas, forestry, and agriculture in the province (industries that are also very reliant on municipal roads, bridges, and other infrastructure).

To illustrate this, the table below shows the proportion of public sector capital stock per capita in relation to combined residential and non-residential private sector capital stock per capita in each province (keep in mind the figures below include both provincial and municipal investments).

Chart 1.5



What this table shows is that for every $1.00 of public sector capital stock spent in Alberta, $21.60 of private capital stock is developed. As you can see, this figure rivals that in Saskatchewan and Newfoundland and Labrador for highest in Canada, and is well above all other provinces and the national average.

This suggests a few things:

1. Although not considered by the panel, public and municipal assets exist for a reason: they support the growth of communities and economic development.

2. The "appropriate" level of spending on infrastructure varies by province, and is context-based. Sure, Alberta municipalities spend more on infrastructure on a per capita basis, but look how much private investment follows! That means jobs and taxes are being invested in the province, but it also means all those wells, farms, and manufacturing facilities need municipal assets (AKA capital stock) to move products to market, access water, etc.

The right level of investment in municipal capital assets is a difficult to define, or even scope. Municipal capital spending can be considered on a per person basis, but it can also be considered through an area-based approach, through the link between public and private sector investment, and many other factors not touched on in this document. The point is, while the MacKinnon Report's analysis uses some alarming statistics to draw some serious conclusions, it's missing the big picture of why municipalities exist, and the purposes they serve. The right way to compare municipal spending probably relies on a combination of many factors, and some way to normalize them across jurisdictions. Figuring out that right way is beyond the scope of this document, but it is surely not found within the MacKinnon Report, which raises questions about the validity of its recommendations.

We're in the Money? Municipal Grants in the MacKinnon Report

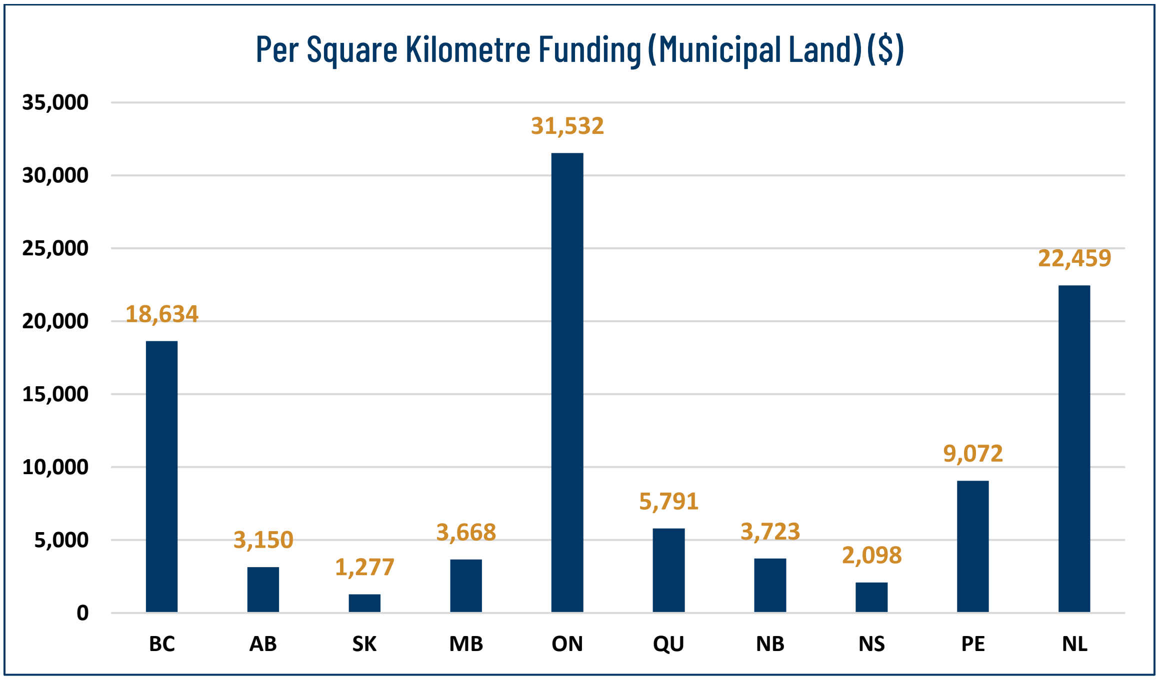
The MacKinnon Report takes a similar approach to comparing provincial spending on municipal funding across provinces. As a reminder, recommendation 15 in the report is quite focused on how the province supports municipal capital spending and suggests some significant changes to that process based on the municipal capital stock per capita figures explained above. Because the report takes a similar approach to arguing that Alberta municipalities receive capital grant funding that is 20% higher than the national average ($440 per capita versus $357), we will take a similar approach in questioning that conclusion. Again, setting aside the fact that the report does not explain what grants are included in these comparisons and that grant processes and scopes and municipal responsibilities vary across jurisdictions, let's again estimate the total funding figures used by the panel in each province based on the table on page 55 of the report:

Table 1.1

PROVINCE	PER CAPITA FUNDING (ESTIMATE BASED ON PAGE 55 TABLE)	POPULATION (STATS CANADA - 2016)	ESTIMATED TOTAL FUNDING
BC	$390	4,648,055	$1,812,741,450
AB	$440	4,067,175	$1,789,557,000
SK	$360	1,098,352	$395,406,720
MB	$320	1,278,365	$409,076,800
ON	$365	13,448,494	$4,908,700,310
QC	$365	8,164,361	$2,979,991,765
NB	$355	747,101	$265,220,855
NS	$120	923,598	$110,831,760
PE	$360	142,907	$51,446,520
NL	$355	519,716	$184,499,180

By again breaking down the funding by land mass, we can see that when we consider the support doled out by provinces to support municipalities in providing services to the land they actually cover, regardless of its population, a different trend emerges:

Chart 1.6



Alberta actually receives the third-lowest level of provincial capital support, ahead of only Nova Scotia and Saskatchewan. This all goes to show that evaluating funding to municipalities is complex, and should not be done based on a single metric.

Conclusion: What does it all mean?

At this point, the MacKinnon Report recommendations are just that: recommendations for the government to consider. RMA is not aware of if, or how the province is using the recommendations to determine their future municipal funding approaches, but it is a fact that some of the other recommendations in the report have already been actioned, so it's likely that these will influence future grant funding decisions.

Undertaking the type of critical analysis and comparison of government performance found in the MacKinnon Report is healthy, and the sign of a government willing to hold itself to account and make changes to deliver services and infrastructure more effectively and efficiently. However, the methods used by the panel and the very serious recommendations that they generated are problematic. Municipal capital spending and grant funding are extremely complex issues that look very different across provinces. As the municipally-focused recommendations in the report would have major impacts on services and infrastructure if implemented, it is fair to have high expectations for the quality of the data and analysis used to inform the recommendations.

Unfortunately, the information shared in the panel does not meet those high expectations. Relying on a single metric, no matter what it is, to frame Alberta municipalities as being responsible for an unnecessary amount of infrastructure – and receiving an unnecessary amount of provincial support for that infrastructure – is quite a leap based on the evidence presented. Not considering what the infrastructure is, how it used, who uses it, how frequently it is used, the extent to which it drives investment and population, and the balance between municipal and provincial responsibilities are all massive gaps that need to be addressed for the panel's recommendations to be seriously considered.

It is also important to consider in more depth the impacts of recommendation 13.

As a reminder, it is:

> *Bring Alberta's net public capital stock in line with the average per capita capital stock in the other provinces over the next ten years as part of its balanced budget plans and long-term fiscal sustainability.*

What does this mean? Does it mean abandoning public infrastructure? Freezing the construction of public infrastructure? Selling existing public infrastructure and outsourcing what has traditionally been public infrastructure to the private sector? Beyond the direct implications to municipalities, the recommendations in the report raise several serious questions that warrant further discussion and clarification, as they would impact both public life and economic development in the province. The panel seems to assume that public infrastructure carries only a cost; that it does not serve a specific purpose or to meet a specific public need. While there likely are innovations that could improve how capital planning and decision-making takes place, and how municipalities are funded, beginning these conversations based on the assumption that Alberta's municipal capital spending and funding is currently out of control is the wrong way to encourage constructive and realistic solutions.