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***Eliminating The Deficit - Establishing A
Sound Financial Framework For The
Northwest Territories***

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RUMINATING THE DEFICIT - ESTABLISHING A
SOUND FINANCIAL FRAMEWORK FOR THE
NORTHWEST TERRITORIES

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Analysis/Review

Eliminating **the** Deficit

**Establishing a Sound Financial Framework
for the Northwest Territories**

NWT
E11
1995



Eliminating the Deficit

Establishing a Sound Financial Framework
for the Northwest **Territories**

July 1995



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Reasons for the Budget Consultation

Why has the Government issued this discussion paper?

The Government of the Northwest Territories is facing a very serious and difficult financial situation. Based on current trends, the GNWT will spend \$100 million more than it collects in revenues in 1996. To prevent this from happening, changes must be made to the GNWT budget,

The Minister of Finance has made a commitment to consult northerners on how the budget should be balanced. This discussion paper is one part of that consultation process. It contains information about the government's current and projected financial situation so that northerners can provide informed comment. It outlines the choices which have to be made in the near future and asks for input from the public on these choices.

The paper is meant to do more than merely recite numbers. It is meant to convey a message. The changes to the 1996 budget will be significant. They will affect everyone. The projected deficit is too large to correct by making a few minor alterations to the budget. NWT residents and businesses must be prepared to lower their expectations of what government can and should do.

Residents of the NWT are undoubtedly aware of the fiscal problems being faced by other governments across Canada. The federal government recently brought down a budget which included huge spending cuts. Many provincial governments have balanced their budgets or reduced their deficits by reducing spending.

The GNWT is not immune to these fiscal problems. High rates of spending growth during a period when the federal government has been restraining or cutting our revenues have led to our current position. To maintain current spending trends, the GNWT would have to borrow large amounts of money. However, this is not an option. The GNWT does not have the financial resources to carry a large debt burden. The Legislative Assembly has recognized this fact and has passed the *Deficit Elimination Act*, which compels the GNWT to balance its budget starting next year.

This will not be an easy task. Given the cuts in the federal Grant to the GNWT, expenditures cannot continue to grow at their current rate. If they do, the deficit in 1996-97 could be as high as \$100 million and could reach \$120 million in 1998-99. This does not include any new costs associated with division of the Northwest Territories, with aboriginal self-government or with the transfer of programs to communities.

Clearly, action must be taken to bring government spending in line with revenues. The question is, what action? Changes to government programs will be needed. Some programs may have to be eliminated. Programs will have to be delivered more efficiently.

Lower levels of services may be necessary. Taxes may need to be increased. Given the very large gap between revenues and expenditures, everyone will have to lower their expectations of what the government can do.

There are no quick and easy solutions to the deficit problem. To put the size of the projected deficit into perspective, \$100 million represents:

- **one half of the GNWT's yearly capital spending**
- ∨ **60 percent of the government's annual tax revenues**
- **one half of the GNWT's direct expenditures on salaries and benefits**
- ∨ **90 percent of the GNWT's spending on local governments**
- ∨ **one third of the spending on health and social services**
- ∨ **two thirds of the government's contribution to education boards**

It is clear that the problem cannot be solved by focusing on only one aspect of government spending or revenues. All elements of the government's budget will be affected. This means all NWT residents will be touched by deficit reduction.

The GNWT is committed to consulting the public on the issue of deficit reduction. The government wishes to obtain feedback from residents, both as users of government services and as taxpayers. For this feedback to be as useful as possible, it is important that everybody involved have the necessary information about the fiscal situation and prospects of the GNWT. This discussion paper provides this information.

What information is in this paper?

The first part of the paper (page 6) reviews the current fiscal position of the GNWT. The Present Situation discusses how the government's revenues and expenditures have grown in recent years and looks at the size of the government's deficit. This section explains why the government finds itself in the current serious financial circumstances, and forecasts what will happen if nothing is done about the situation.

The second part of the paper, Government Expenditures (page 10) looks at where the government spends its money now. It examines the demands that are currently being made on the GNWT, demands that are not expected to diminish over the next few years. Some potential expenditures which could seriously worsen the GNWT's fiscal situation in the next four years are summarized.

A third section looks at how the government can cut expenditures (page 17). This section reviews the various methods of trimming costs, and the steps that have been taken to date.

The fourth section is Revenues, (page 25). This section looks at where the GNWT raises revenues now, and the limitations on using tax revenues to solve the deficit problem.

A fifth section, Taxation, (page 31) reviews options for increasing tax revenues. The possibility of new mining and oil and gas development, and what that may mean for GNWT revenues, is also discussed.

The final section, Consultation, (page 44) outlines the consultation process, and invites all NWT residents to participate.

To make it easier to understand the technical words and phrases used in this paper, a glossary has been included. Words included in the glossary are shown in bold type on their first appearance.

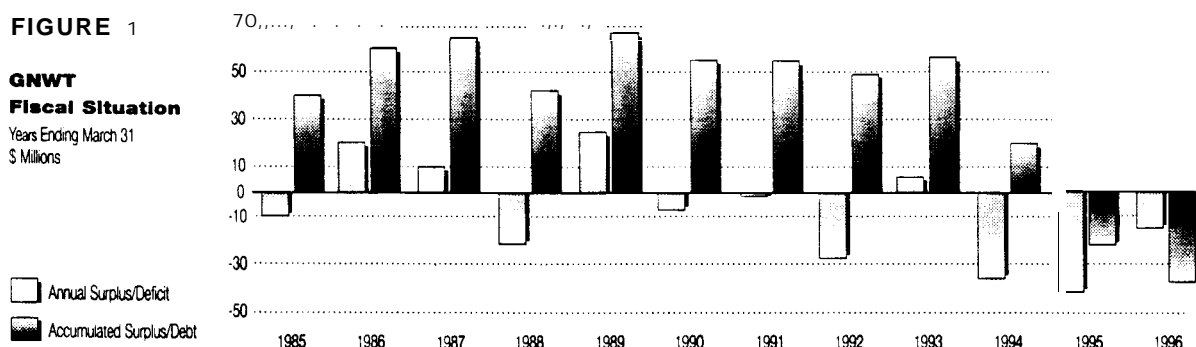
The Present Situation

What is the **GNWT's** current fiscal situation?

For more than 20 years, the GNWT was able, on average, to balance its budgets and to maintain a comfortable accumulated surplus. Over-spending one year was financed from the government's savings and then paid back by limiting spending later.

FIGURE 1

**GNWT
Fiscal Situation**
Years Ending March 31
\$ Millions



This situation has changed dramatically in the last few years. Revenue growth has dropped sharply since 1990 as a result of the reduction in the growth of the Grant from Canada (Formula Financing Grant). GNWT expenditures, however, have kept on growing. The result is that the GNWT is forecasting its third deficit in three years in 1995-96. The accumulated surplus, or savings the government used to fall back on, is now gone. The GNWT will be more than \$38 million in debt by the end of the 1995-96 fiscal year.

The GNWT has tabled balanced budgets for the last two years.

How did we get into this position?

Despite the fact that the GNWT tabled balanced budgets in 1993-94 and 1994-95, actual expenditures in both years were significantly higher than anticipated. As a result of the elimination of funding by Canada Mortgage and Housing Corporation for new social housing construction, the GNWT was forced to increase spending by \$10 million in 1993-94 and by \$17 million in 1994-95 to fill the gap. Because the summers of 1993 and 1994 were extremely dry, there were large unforeseen expenditures in the forest fire management program. In fact, 1994 was the worst and most costly forest fire season since the GNWT took over the forestry program from the federal government in 1986. Fighting these fires cost the GNWT an additional \$10 million in 1993-94 and an extra \$20 million in 1994-95.

These and other unexpected expenditures caused the GNWT to complete the 1993-94 fiscal year with a \$35 million deficit, and the 1994-95 year with a total deficit of about \$42 million.

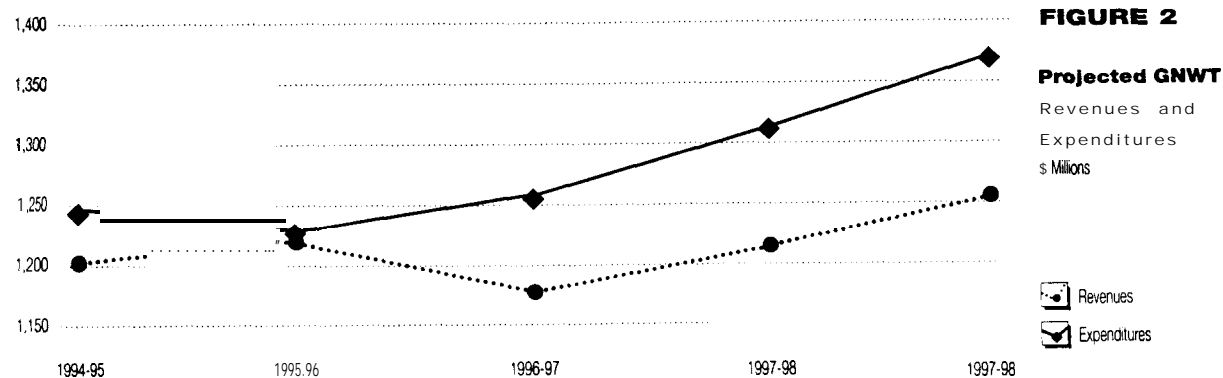
Are these just one-time problems?

These higher than budgeted expenditures should not be dismissed as one-time problems. Government expenditures have been growing faster than revenues for a number of years. Since 1990-91, expenditures have grown at an average rate of 4.4 per cent per year while revenues have grown by only 3.5 per cent per year.

The government is faced with demands to increase spending even more. These demands are discussed in the next section, Government Expenditures.

What will happen if no changes are made to our planned spending?

Given the federal government's decision to freeze the Formula Financing Grant in 1995-96 and to reduce it in 1996-97, it is very likely that the GNWT's total revenues, including the Grant, will not grow at all in 1995-96 and will fall substantially in 1996-97. If past rates of spending growth continue unchanged between 1995-96 and April 1, 1999, the date Division takes place, the GNWT will have an accumulated debt of more than \$350 million, without counting the interest costs that would have had to be paid since 1995-96.



What's wrong with borrowing to finance deficits?

At first glance, borrowing to finance deficit spending may appear to have some advantages. Borrowing allows the government to build capital infrastructure such as roads and hospitals now and pay for them over the life of the assets. Borrowing also allows for a more stable rate of change in revenues or expenditures. Rather than making sudden, disruptive cuts in spending or increases in tax rates when revenues fall, borrowing allows these changes to be made over a longer period of time.

The problem is that assets must be paid for, sooner or later, and the cost of borrowing must be included in the payment. Interest payments should be met by reduced spending, or the effect will be to perpetuate deficits. Borrowing to cover revenue shortages is a short-term solution which merely postpones the inevitable.

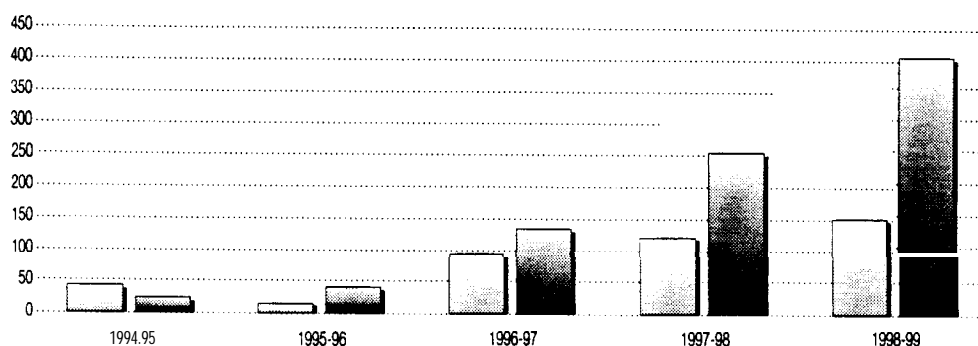
If the necessary measures are not taken, and deficit financing is continued for just a few more years, the GNWT'S debt load will become unmanageable, and will seriously threaten the government's ability to meet its financial obligations. This in turn would threaten the GNWT's ability to deliver services.

When the cost of borrowing is added to the GNWT projected deficit, the debt load grows even more quickly. If we assume interest rates of nine percent per year, and current revenue and expenditure projections, the GNWT will owe \$410 million by the end of 1998-99 instead of \$350 million. This is because the government would have to borrow an additional \$60 million to pay interest costs. Annual interest expense in 1996-97 would be about \$8 million. By 1998-99, three years later, annual interest expense would be more than \$30 million, as a result of compounding, or paying interest on interest. Figure 3 illustrates how quickly this situation can grow into a crisis.

FIGURE 3

Projected GNWT
Budgetary
Balances
\$ Millions

□ Deficit
■ Accumulated Debt



The cost of borrowing depends on interest rates which change from time to time. Borrowing would make the GNWT vulnerable to these changes. Rising interest rates would increase the deficit, and would force the government into expenditure cuts, tax increases or more borrowing.

Finally, the GNWT is a small jurisdiction, with a limited revenue base from which to finance interest payments. The amount that the GNWT could borrow is limited. At some point, investors might decide GNWT debt is a poor risk and would demand a higher interest rate in compensation. Eventually, it could become difficult to find investors willing to lend money to the GNWT. This is the problem faced by some of the smaller provinces, and the federal government, today. The threat of a lower credit rating, and the resulting higher rate of interest payable has forced these governments to drastically reduce their deficits. The GNWT would soon find itself in this position, because its ability to raise revenues is so much less than that of the federal or provincial governments.

What is the Deficit Elimination Act?

To ensure that the GNWT never faces this problem, the Legislative Assembly has passed the *Deficit Elimination Act*, which compels the government to balance its budget.

According to the Act, expenditures must not exceed revenues for each of the fiscal years from 1996-97 to 1998-99. Because it is impossible to predict either revenues or expenditures with 100 percent accuracy, the Act allows for a deficit of up to one percent of revenues in 1996-97 or 1997-98. However, any deficits must be made up with surpluses in the following fiscal year. Spending cannot be greater than revenues in 1998-99.

If the targets are not met, the Act requires the Legislative Assembly to debate whether to remove Cabinet Ministers from office. However, this would depend on the circumstances which prevented the conditions of the Act from being met.

How can we meet these targets?

Given the large deficits forecast for 1996-97 and 1997-98, meeting the targets in the *Deficit Elimination Act* will require hard choices, both on the expenditure and the revenue side. The size of the gap between projected revenues and expenditures is very large. Decision-makers need to know how this gap can be eliminated. Should programs be changed? Should taxes be increased?

The following sections look at the GNWT's expenditures and revenues and the measures that could be taken on each side of the budget equation to achieve a balanced budget.

Government Expenditures

How much money does the GNWT currently spend, and how is it spent?

GNVVT spending has doubled over the last 10 years, from \$612 million in 1985-86 to over \$1.2 billion in 1995-96. This represents spending growth from \$11,000 per person to more than \$19,000 per person in the NWT. This is three and a half times the average provincial spending per person.

Table 1 shows a summary of planned 1995-96 GNWT spending by category. For a more detailed breakdown, please see Appendix 1.

TABLE 1

GNWT Expenditures by Category	\$000	Share of Budget
1995-96 Main Estimates "1 - salary costs		
Payments to Persons	64,573	6%
Payments on Behalf of Persons	90,939	7%
Payments to Organizations and Other Levels of Government		
O&M	467,689	
Capital	27,881	
	495,570	41%
Direct Spending		
Leases	35,587	
Building and Vehicle Maintenance'	28,659	
Utilities	24,603	
Forest Fire Fighting and Prevention *	22,471	
Corrections *	20,424	
Highway Maintenance Operations'	16,501	
courts *	8,891	
Ferry Operation and Maintenance'	3,646	
Interest Payments	1,902	
Insurance	1,776	
	164,460	13%
Other Salaries and Wages	150,146	
Other Direct O&M Spending	87,678	
	237,824	19%
Capital	166,776	14%
Total Direct Spending	569,060	
Total	\$1,220,142	100%

Why are GNWT expenditures so high and why are they growing so fast?

It is very expensive to deliver public services in the NWT. Vast distances, a small and widely-spread out population, a harsh climate and limited transportation alternatives all contribute to the cost. In addition, huge demands have been made on the GNWT to provide services and infrastructure. In many communities, the government is the only source of economic activity.

Some of the increase in GNWT spending is due to the transfer of programs, such as health and forestry, from the federal government. The funding provided by the federal government was sufficient to pay for these programs initially, but has not kept pace with growing demands made on the programs. Spending has also grown to meet demands on existing GNWT programs. Spending is being driven by a number of factors including:

- **population growth;**
- **the consumption of health services;**
- **socio-economic conditions; and**
- **increasing expectations.**

These factors result in increased use of the health and education systems, increased use of social assistance, increased need for social housing and increased demands on the courts and corrections programs. There is no indication that these pressures will be less by 1999. In fact, there is every sign that they will increase.

How does population growth affect government spending?



The population of the NWT has grown much faster than that of Canada, although the difference has been narrowing over the past few years. To analyze the implications for expenditure growth, we must divide population growth into two parts: *natural increase* and *net migration*.

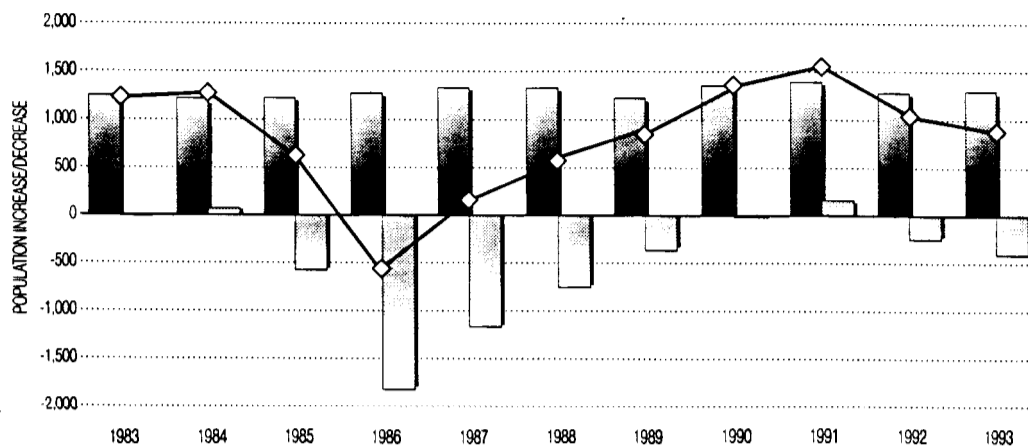
Natural increase is the difference between the number of births and the number of deaths in any year. Net migration is the difference between the number of people who move into the territories in any year and the number of people who leave. The rate of natural increase in the NWT is about three times the Canadian average, due mostly to a high birth rate. This high rate of natural increase is partly offset by net outmigration from the NWT. Historically, more people leave the territories each year than move here.

Figure 4 shows that actual population growth can vary significantly from year to year, and in fact has been falling in the last two years. This is because of net outmigration. However, the amount of natural increase has remained steady, and is expected to do so for the next 10 years.

FIGURE 4

Northwest Territories Population Change

 Natural Increase
 Net Migration
 Net Population Change



The GNWT spends two-thirds of its budget on programs such as housing, health, education, social services, and municipal infrastructure, which are directly affected by population growth. This means that expenditure demands caused by a growing population are not expected to decline.

Two programs, education and housing, are facing severe spending pressures as a result of this natural population growth.

Education

The demand for education programs in the NWT has grown dramatically in the last few years, partly because of population growth and partly because more children are staying in school longer. Total school enrolment grew 14 percent between 1990-91 and 1993-94 and high school enrolment increased 77 percent over the same period. The number of students receiving post-secondary grants and loans grew 40 percent between 1989-90 and 1992-93. While it appears that the government's efforts to encourage students to stay in school longer are having some effect, this has placed immense pressure on government spending.

The Department of Education, Culture and Employment, in its September 1994 strategy paper *Peep/e: Our Focus for the Future - A Strategy to 2070*, forecasts enrollments will increase an additional 50 percent in 15 years and student financial assistance costs will double over the same period.

Housing

There is a severe shortage of adequate housing in the NWT. The NWT Housing Corporation's 1992 *Housing Needs Survey* identified 3,584 households, or 25 percent of those surveyed, to be in core housing need (households which had problems with the suitability, affordability or adequacy of their housing). This represents a 14 percent increase over the 1990 survey.

According to the 1991 Census, there are, on average, 3.5 persons per household in the NWT, compared with 2.7 in Canada. This is a 30 percent difference. Overcrowding contributes to a number of social and health problems, such as higher rates of violent crime, higher rates of communicable diseases and poor school performance. Continuing high birth rates and increasing numbers of people forming families suggest the demand for housing will increase faster than population growth.

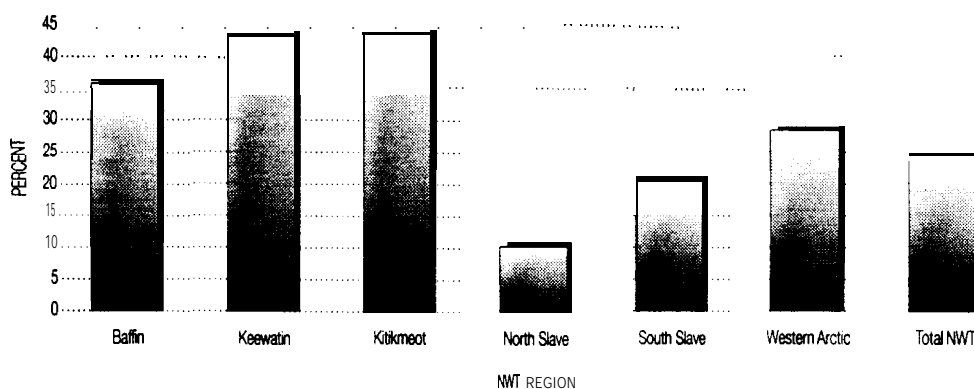


FIGURE 5
1992 Housing Needs Survey
Percentage of Households in Core Need

In the past, the federal government has been a major financial contributor to the construction of new social housing in the NWT. As of 1994, however, the federal government withdrew from this program, leaving the GNWT on its own to find the necessary funding to continue building new social housing.

How do health conditions affect government spending?

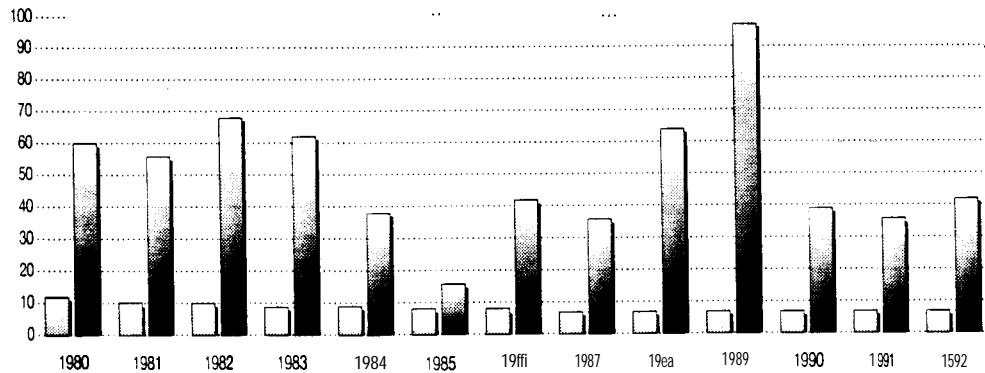
Health costs are affected by population growth, since this growth results in more people who may require care. A number of other factors also contribute to the cost of providing health care.

GNWT medical care costs increased almost 20 percent between 1991-92 and 1994-95. This increase is not caused by population growth alone. Nor is this increase unique to the NWT. For the last decade, governments across Canada have been concerned about the rising cost of providing health care services to residents. Rising costs have been caused by a number of factors, including the development of new and more expensive technologies and drugs, the ageing of the population, an increase in the number of doctors per person and an increase in the utilization rate (the number of services performed by physicians compared to the total population),

Some factors have affected health care costs more than others. For example, the NWT utilization rate increased 20 per cent between 1988 and 1992. The cost of new technologies and drugs has certainly had a major impact in the NWT. The ageing of the population, while relevant to the NWT, has had less impact on health care costs here, where the population is relatively young, than in the rest of Canada, where the average age is quite a bit higher.

There are two other major factors which affect the cost of health care delivery in the NWT. First, health conditions in the NWT are among the worst in Canada. Rates of tuberculosis and other communicable diseases are far above the national average. The infant mortality rate, although falling, was still almost three times the Canadian average in 1992. Second, the cost of providing adequate medical treatment to communities which are small, remote and hard to get to is very high.

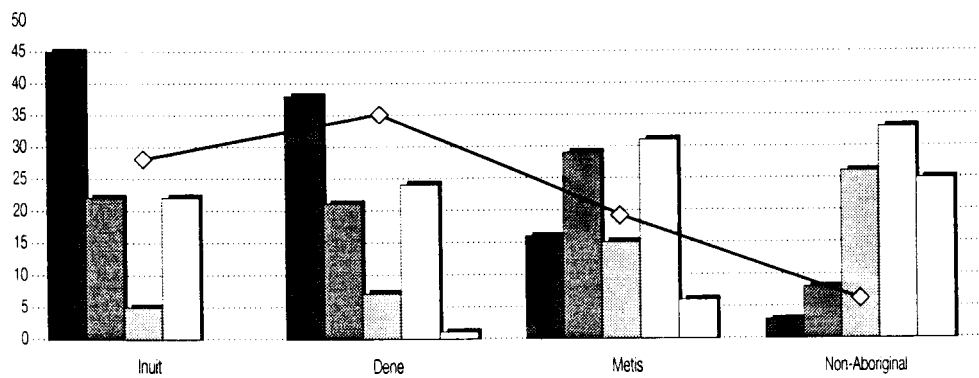
FIGURE 6
New and Reactivated Tuberculosis Cases
Rate per 100,000 Population
Canada
Northwest Territories



How do **socio-economic** conditions affect government spending?

Continuing high unemployment rates in the NWT, especially in smaller communities, mean that the demand for social assistance is high. The overall unemployment rate in the NWT in January 1994 was 17 percent compared to 11 per cent for Canada. Among aboriginal people the rate was 30 percent. Many aboriginal people do not have the required qualifications to take advantage of jobs that are available.

FIGURE 7
Level of Education and Unemployment Rate, 1994
Per Cent of Working Age Population
Less than Grade 9
Grades 9-11
High School Diploma
Other Certificate or Diploma
University Degree
Unemployment Rate



Social assistance costs increased almost 50 percent between 1990 and 1994. The number of people requesting and receiving social assistance increased almost 30 percent over the same period. This increase is five times the rate of growth of the population. A number of factors are responsible. The population in many communities has increased faster than the number of available jobs, People are also relying more on the cash economy than on traditional hunting and fishing lifestyles.

How do people's expectations affect government spending?

Over the years, the demand for public services has grown. This is, to some extent, the result of a changing society where traditional support structures such as family, church and communities play a reduced role. Governments have tried to meet this demand and when they have not had the money to pay for these services, they have borrowed. This is one of the reasons that so many governments now face a fiscal crisis,

In the NWT as well, residents have turned to government to meet needs that, in many cases, have been pressing. The government has responded to the best of its ability to provide needed services and infrastructure. However, reduced revenues mean that the GNWT may no longer be able to respond to all the requests that are made for increased spending.

What does this mean for the future?

Social, economic and health conditions in the NWT are not going to change overnight. The NWT will continue to have to deal with these serious and persistent problems. A large number of young people will be looking for education, jobs and housing over the next ten years. The growth in demand for health care, education, housing, and social assistance is not going to diminish in the near future. New, more efficient and less expensive ways of providing services must be found.

The GNWT is trying to find new and more efficient ways to deliver income support programs. Education and training will become important parts of income support, and delivery systems will change. Alternative ways of delivering health care are being looked at, but real improvement in the health of NWT residents depends on better social conditions. All these factors will continue to put immense strain on the financial resources of the GNWT.

Is there anything else we should know about?

In addition to these spending pressures, the GNWT faces a number of potentially large expenditure requirements which could worsen the GNWT's fiscal position. These include:

Pay equity:

In March 1989 the Union of Northern Workers, which represents the majority of the GNWT's employees, filed an equal pay complaint with the Canadian Human Rights Commission (CHRC) against the Government under the Canadian Human Rights Act. Negotiations to settle this complaint ended unsuccessfully in February 1993 with the parties about \$60 million apart. The issue is currently before the Federal Court of Canada which has been asked to determine whether the CHRC has jurisdiction to hear the complaint.

Environmental cleanup initiatives

The GNWT recognizes that it may face large environmental cleanup costs. Such costs would include the cleanup and restoration of oil storage facilities, mine sites, construction sites, sewage treatment facilities and the removal of hazardous wastes. Although the federal government would share a large part of this responsibility, and no estimate of the costs can be made at this time, the potential liability is large.

Health status - increased illness:

The cost of delivering health care in the north is very high. However, the potential exists for even greater strain on the health care system, if the incidence of illnesses such as AIDS or tuberculosis becomes more widespread.

Infrastructure costs for large-scale non-renewable resource development:

Depending on the scale of the project, the GNWT could find itself facing large demands for infrastructure such as roads and airports. In addition, any resulting inflow of population would add to the pressures on most government programs.

Federal budget reductions:

The 1995 federal budget announced spending cuts totalling \$25 billion over the next three years, accompanied by reductions of 45,000 public service jobs across Canada. These cuts will certainly affect federal spending in the NWT, either directly, or via cuts to transfers to the GNWT. Some reductions, such as the elimination of funding under the Economic Development Agreement, have already been announced. As additional cuts are announced, there may be increasing pressure on the GNWT to replace funding or services previously provided by the federal government.

Political Development:

The fiscal effects of division of the NWT and aboriginal self-government have yet to be determined. These costs depend on the form of government adopted by the two territories and the successful negotiation of adequate funding from the federal government.

Spending Reductions

How can government spending be reduced?

There are a number of approaches that can be used to reduce spending, each with its own strengths and weaknesses. Over the last five years the GNWT has tried most of these approaches at different times.

Across-the-Board Cuts

One approach to expenditure reduction is to apply across-the-board measures which affect all departments and programs in much the same way. An example of this might be a 10 percent cut to all departmental budgets. The advantage of this approach is these reductions can be applied fairly quickly, with immediate financial results. The drawback is that they may not reflect people's needs or priorities - health care expenditures are hit the same way as transportation spending, and the education budget is cut the same way as economic development funding.

Across-the-board spending cuts do not address why demand for some programs is growing, nor do they look at whether programs are being delivered as efficiently or as effectively as possible. Across-the-board approaches may be necessary to achieve short-term objectives, but if this is the only approach used to cut spending, over the longer term all government programs will be underfunded and some programs may be stretched to the limit and be unable to operate effectively.

Program Reviews

Another approach involves conducting program reviews. A review looks at what a program is supposed to achieve, and tries to find the most efficient and effective way to meet the need. This might mean major changes in the way some programs are delivered. Low priority programs might be eliminated, and the money redirected to higher priority areas. The review process can be lengthy, because it requires careful thought and considerable consultation. Usually, changes cannot be made quickly and results are not achieved overnight. However, reviews may be more effective in the long run in reducing costs if parties involved can agree with the need for change.

Improved Efficiency

Improving the efficiency of program delivery is a key component of budget reductions. Government departments have to find less costly ways to deliver services. It is important that these efforts be co-ordinated, so that program changes in one department do not lead to increased costs for other departments. It may be possible for several departments to work together to develop joint service delivery, at less overall cost. This concept of co-ordination was adopted in the 1995-96 Main Estimates "envelope" presentation. Departments were asked to identify areas of increased demand for programs, areas where new spending is required, potential spending reductions, and sources of

increased revenue. Three Envelope Committees were established which grouped government departments serving similar purposes, one each for social programs, resource management and development and government infrastructure,

TABLE 2

**GNWT Envelope
Committee/
Responsibilities
1996-96**

Social Programs	Resource Management and Development	Municipal and Government Infrastructure
Education, Culture and Employment	Transportation	Municipal and Community Affairs
Health and Social Services	Renewable Resources	Public Works and Services
Justice	Economic Development and Tourism	Executive
NWT Housing Corporation	NWT Development Corporation	Finance
	Safety and Public Services	Legislative Assembly
	Energy, Mines and Petroleum Resources	Personnel

The envelope approach helped ensure that actions taken or proposed by one department were considered in relation to the implications for another department. It helped to make decision makers more aware of how budget measures affect other programs and helped to identify areas where joint efforts could lead to increased effectiveness and lower costs. The use of Envelope Committees also provided Ministers with the opportunity to examine and discuss priorities within the various “envelopes.”

The programs grouped in the “Social” envelope are those which address the social conditions faced by NWT residents - health, education, housing and justice. The “Resource Management and Development” envelope groups departments and agencies which address issues relating to the NWT’s resources and economy. Finally, the “Government and Municipal Infrastructure” envelope includes those departments which provide support to GNWT program departments or to local governments. Some of the expenditures in the Government and Municipal Infrastructure envelope directly support the delivery of programs. For example, expenditures of the Department of Public Works and Services include utility and maintenance costs for schools, senior citizens’ residences, and other government-run facilities. Table 3 shows government spending by envelope, with these delivery support costs allocated to the appropriate envelope.

	<u>\$ Millions</u>
Social Programs	
Health and Social Services	289.6
Education, Culture and Employment	272.6
NWT Housing Corporation	111.0
Justice	77.8
	<u>751.0</u>
Resource Management and Development	
Transportation	87.7
Renewable Resources	57.5
Energy, Mines and Petroleum Resources	6.2
Economic Development and Tourism	45.8
Safety and Public Services	8.8
	<u>206.0</u>
Government and Municipal Infrastructure	
Legislative Assembly	12.6
Executive	43.7
Finance	7.8
Personnel	12.9
Public Works and Services	73.0
Municipal and Community Affairs	113.1
	<u>263.1</u>
Total Expenditures	<u>1.220.1</u>

TABLE 3

GNWT
1995-96
 Expenditures by
 Envelope and
 Department

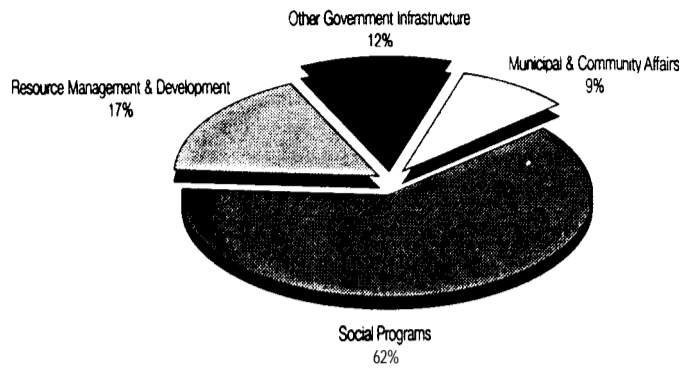
How much does the GNWT spend on social programs?

Most GNWT spending goes to fund social programs in the areas of health, education, social services and housing.

The review of income support programs by a special task group, is an example of how the cost of social programs can be addressed. Income support programs include social assistance, social housing and student financial assistance. The GNWT spent about \$175 million in 1994-95 on these programs, of which \$35 million was recovered from the federal government.

FIGURE 8

GNWT
Expenditures by
Function
1995-96 Main Estimates



The GNWT has made the reform of income support a priority. The special task group is looking at issues such as:

- Are these programs the most effective way to deliver income support?
- Do government programs encourage people to become less dependent and more self-supporting, or do they actually prevent this from happening?

If income support programs can be redesigned to encourage people to get training and make it easier for them to find the help they need, the demand for income support programs might eventually decline. The Department of Education, Culture and Employment has issued a discussion paper called *Creating Choices: Solving the Income Support Puzzle*, and has implemented pilot projects to help in the redesign of income support in the NWT. This is a long-term exercise which may result in fundamental changes to the way these programs are delivered, it must also yield savings through more efficient delivery methods.

How much of the government's budget is spent on the public service? Wages, salaries and employer-paid benefits, such as vacation travel assistance and housing allowances, make up the largest part of the government's operating budget (Figure 9).

In the GNWT, direct expenditures on salaries and benefits total about \$215 million, and indirect salary costs paid by boards and agencies an estimated \$240 million. Together these two expenditures represent more than one third of the government's total spending and over 40 percent of Operations and Maintenance (O&M) spending.

The largest portion of these expenditures is payment of salaries and wages, including overtime (Figure 10). Smaller portions go to pay allowances such as the housing allowance; contributions toward pensions, unemployment and other insurance; and other benefits such as vacation travel assistance, medical travel assistance and moving costs. Appendix 2 provides a more detailed breakdown of the cost of GNWT employee salaries and benefits.

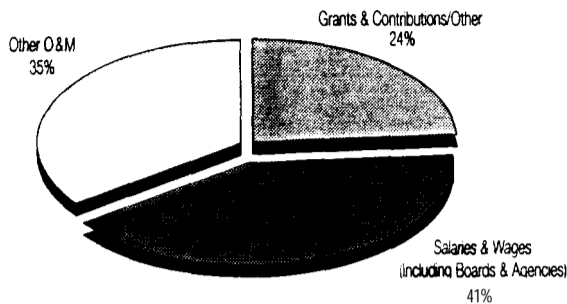


FIGURE 9

**GNWT
1995-96 O&M**
Spending
By Type of Expenditure

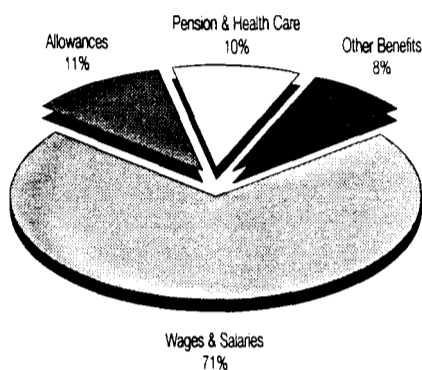


FIGURE 10

Breakdown of
GNWT Employee
costs
Including Boards
& Agencies

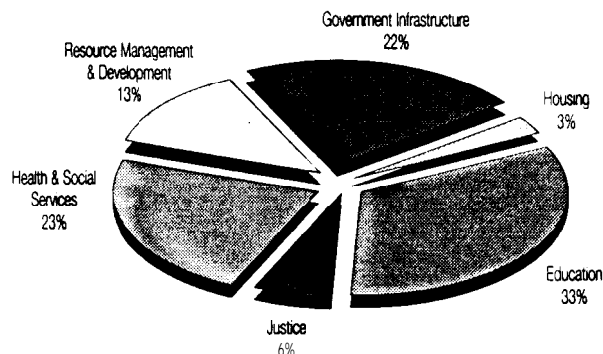
Federal and provincial governments have reduced personnel costs in the past few years, through various measures. These include pay freezes or reductions, reductions in the number of days of work through unpaid holidays, suspension of merit pay increases, and layoffs.

The GNWT has implemented some, but not all, of these measures. As part of the 1992-93 deficit reduction program approximately 160 positions were eliminated. The 1995-96 budget reduced the total number of funded positions allocated to government departments by more than 50. Collective agreements provided for no salary increases in 1992-93 and a 1.8 per cent increase in 1993-94. An agreement was reached with the NWT Teachers' Association for no salary increases in 1994-95 and 1995-96 and a reduction in non-wage benefits such as vacation travel assistance. The GNWT has extended these restraint measures to management and employees who are not in the collective bargaining unit. A consistent position has been taken in negotiations with the Union of Northern Workers.

Members of the Executive Council and senior management have also accepted reductions in their salaries. In December 1991, Premier Cournoyea announced that her annual salary would be reduced by \$7,000, salaries of Ministers by \$5,000 and those of Deputy Ministers by \$2,500. This was a public signal of the seriousness of the government's cost containment objectives.

FIGURE 11

1994 GNWT
Employees by
Function
Including Boards
and Agencies



Most civil servants are direct providers of government services (Figure 11). Others are required to support and manage the programs and services now in place. Any reductions in the numbers of civil servants will affect the levels of program and service delivery, or will require changes in the way programs are delivered. There is also a large administrative component to the public service. This is because of the way programs are delivered in the NWT, through boards, agencies, and other organizations. Each layer of administration between the GNWT and the recipient of government services adds to the overall cost of delivering programs. Appendix 2 shows the breakdown of GNWT positions by job category.

How much does the GNWT provide to municipalities, boards and agencies?

Governments in Canada, faced with the need to reduce deficits, have been forced to transfer part of the burden of deficit reduction to other levels of government. The federal government has made substantial reductions to the growth in transfer payments to the provinces and territories, and further cuts are coming. In turn, the provinces have reduced the growth of funding to municipalities, school boards, hospitals, and other agencies. Other organizations which depend on government support have also faced restraint and reductions.

The GNWT spends about \$455 million, or 44 per cent of its Operations & Maintenance (O&M) budget, on grants and contributions. The main recipients are municipalities, health boards, boards of education and the NWT Housing Corporation. Appendix 3 lists the grants and contributions planned for 1995-96.

What about capital spending?

Capital spending is money used to build schools, hospitals, community centres and arenas, social housing, roads, airports, etc. and to purchase equipment such as vehicles. The GNWT has allocated \$195 million in 1995-96 for capital spending, or about

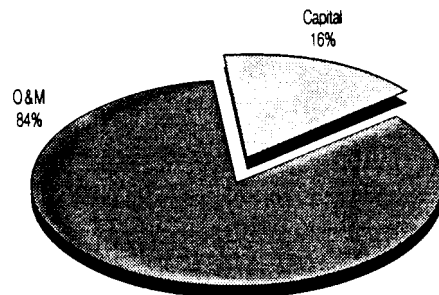


FIGURE 12

1995-96 GNWT Expenditures
O&M Versus Capital

16 per cent of its total budget (Figure 12). It is certainly possible to reduce capital spending in a given year by canceling construction projects or purchases. However, a certain level of capital spending is necessary to avoid running into higher maintenance and repair costs on existing buildings and equipment in the future.

Since 1992-93, the GNWT has established three-year capital planning targets for departments. This encourages longer-range planning. Departments work within a five-year capital plan and can assume, unless there are serious funding changes, that they have a defined target for a **three-year period**. This makes it easier to consult with communities and to plan for the use of northern contractors and northern labour.

As part of the government's efforts to control spending growth, a committee of senior officials has begun to review the capital planning process, the management of capital projects and the government's capital standards. Capital standards are the measures the government uses to determine what capital infrastructure is required in each community. Standards may need to be reduced or rethought. For example, instead of putting two or more libraries in a community - a public library, a school library and an adult education library - the same services could perhaps be delivered by only one library, attached to the school, but with a separate entrance allowing access by the public.

Where else can the government save money?

About 35 per cent of the government's Operations and Maintenance spending goes to pay for "Other O&M." This category includes a wide variety of services from general items such as office accommodation and supplies, consulting services, travel and utilities, to the purchase of RCMP services from the federal government.

In 1993-94, the GNWT conducted reviews of four specific areas: travel and transportation, including medical travel; utilities; staff housing; and fees for government services.

These reviews did not look at the need for individual programs but instead were aimed at finding specific ways to make program delivery more efficient. For example, improved travel management, including medical travel, resulted in savings of \$3.2 million. Overall, total budget reductions of \$17 million were approved as a result of these reviews.

How can we measure the value of government spending?

Making choices between government programs will be very difficult. It may be useful to establish some guidelines against which government spending can be measured. As a start, the following issues might be considered:

- Does the program continue to have a useful purpose?
- Is the program achieving what it was meant to achieve?
- If the program should continue, can it be delivered more efficiently?
- Are two or more programs providing similar or related services?
- Could levels of service be reduced?
- Does the government have to deliver the program, or could it be transferred to the private or voluntary sector?

The next section examines the other side of the government's budget - revenues,

Revenues

FORMULA FINANCING

What is the Formula Financing Grant?

The Formula Financing Grant from Canada is the largest single revenue source for the GNWT (Figure 13). The Grant totalled \$880 million in 1994-95, more than 70 percent of

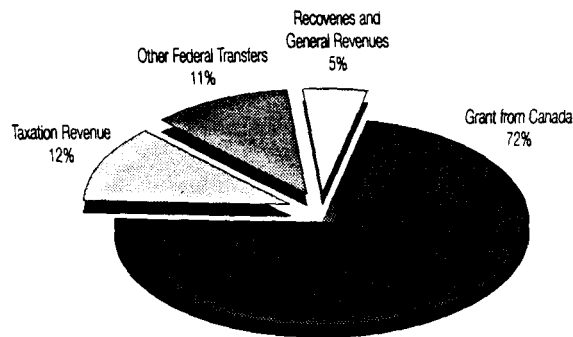


FIGURE 13

GNWT Revenues
by **Source**
1995-96 Man Estimates

total revenues. (A short history of formula financing and a description of how the Grant is calculated is provided in Appendix 4.) The Grant is calculated according to a formula outlined in an agreement between the GNWT and the federal government. The terms are largely determined by the federal government.

The GNWT expected that the Grant would be reduced as part of federal restraint measures. In February 1995, the federal government announced a freeze in 1995-96 and a reduction of the Grant in 1996-97 of close to \$60 million. The GNWT will have to make up for the lower Grant through spending cuts, through tax increases, or both.

TAXES

Why do we need taxes?

In a democratic society, residents pay taxes to support the programs undertaken by their government. The primary purpose of taxes is to raise money. However, as far as possible, taxes should be fair and efficient.

What is a fair tax system?

Fairness in taxation includes a number of considerations. First, taxpayers with similar incomes, similar family circumstances and similar spending patterns should pay similar amounts of taxes. This is referred to as horizontal equity.

Second, taxpayers with different incomes, family circumstances and spending patterns should be subject to levels of taxation that reflect their different circumstances. This is referred to as vertical equity. For example, all Canadians would agree that it is fair that

those with higher incomes should pay more tax. Most Canadians would probably also agree that taxes should be progressive, that is, people with higher incomes pay a higher percentage of their incomes in tax. Some taxes, such as sales, fuel or tobacco taxes, are levied on everyone at the same rate. The tax system as a whole can be progressive, even if some of the individual taxes which make it up are not.

While it is generally accepted that a progressive tax system is fair, there is no agreement over the degree to which higher-income individuals should bear higher taxes. In addition, many high income earners are mobile. If too high a tax burden is imposed on any one segment of society, these people may move, or may move economic activity, to other jurisdictions, where tax rates are lower.

What is an efficient tax system?

A tax should be administratively efficient. This means it should be relatively easy and inexpensive for taxpayers to comply with and for government to administer.

Generally, taxes should not influence individual and business decisions. For example, a sales tax which applies to the retail price of a broad range of goods and services will not influence consumers to make decisions based on tax considerations, since all goods are taxed at the same rate. However, a sales tax at the manufacturing level affects the relative price of domestically-produced goods compared to imports. A tax that minimizes distortions and other influences is said to be efficient relative to other taxes.

In some cases, taxes are used to help change purchasing decisions. For example, because many of the costs associated with the consumption of alcohol and tobacco are paid by society, some governments tax these products heavily to discourage use.

Taxes pay for government services and therefore benefit society as a whole. Taxes also have a cost. Sales taxes increase the price of goods and services, so consumers buy less. Taxes on individual incomes reduce disposable income (the amount of money people have to spend) so people buy fewer things.

Who pays taxes?

All taxes are ultimately passed on to individuals. Even taxes imposed on businesses are passed on through higher prices, and sometimes fewer jobs. Business owners pay through reduced profits.

Taxes can also be "exported" or "imported". This means some NWT taxes are paid by non-residents and some of the taxes paid by NWT residents go to other provinces.

What taxes does the GNWT currently levy?

Under the federal *Northwest Territories Act*, the GNWT has the authority to levy the same taxes as the provinces, with the exception of resource **royalties**. Provincial authority to levy taxes is generally limited by the Constitution to direct taxation within the province. The GNWT collects taxes from most of the same sources as the provinces, but does not charge a retail sales tax or a capital tax.

	<u>\$ Millions</u>
Personal Income Tax	62.6
Corporate Income Tax	30.3
Tobacco Tax	16.7
Liquor Control System	16.9
Fuel Tax	12.3
Payroll Tax	12.4
Property Tax & School Levies	5.8
Insurance Taxes	1.0
Licences, Fees and Permits	9.3
Total	167.3

TABLE 4

GNWT
Tax **Revenues**
1995-96 Main
Estimates

In 1995-96, the GNWT expects to collect about \$167 million in tax revenue, or \$2,600 per person (Table 4). This is about 30 percent less than the provincial average of \$3,900 per person. Tax revenues represent only 12 percent of total GNWT revenues, compared with an average of 62 per cent for the provinces. While tax rates are lower in the NWT, government spending per person is much higher.

How do NWT tax rates compare to the provinces?

	Personal Income Tax	Gasoline Tax	Tobacco Tax (Cigarettes)	Payroll Tax	Corporate Income Tax	
	% of Federal tax	cents per litre	\$ per carton	%	Small Corporation %	Large Corporation %
NWT	45.0	10.0	24.80	1.00	5.0	14.0
Canadian Average ¹	55.4 ²	13.6	8.74	1.92	7.9	14.1

TABLE 5

Selected
Provincial and
Territorial Tax
Rates as of
January 1, **1995**

¹ Averages of all provincial and territorial rates, weighted by population.

² Excluding Quebec (which levies a personal income tax directly against taxable income), and also excluding provincial credits and surtaxes.

Table 5 shows that NWT tax rates are among the lowest in the country. For example, our personal income tax rate is 45 percent of Basic Federal Tax, compared to the Canadian average of 55.6 per cent. All provinces (except Newfoundland) also levy high-income **surtaxes** (an additional charge on higher income earners, for example, a surtax of 8% on provincial tax over \$1 3,500), flat taxes (an income tax expressed as a fixed percentage of income), or both. **Most** provinces and territories also have a number of

tax credits which reduce the amount of income tax payable. A more complete comparison of NWT and provincial tax rates is included as Appendix 5.

Because of these additional surtaxes, flat taxes and credits, a comparison of the basic provincial and territorial tax rates may not present a complete picture.

Table 6 shows actual average provincial and territorial income tax rates for 1992 expressed as a percentage of taxable income. Because personal income taxes in Canada are progressive, the average tax rate in lower-income provinces is less than that in higher income provinces. It should be noted that this table only shows the average provincial/territorial tax rate paid in each jurisdiction in 1992. The rates paid in each jurisdiction by many individuals will differ from the average. As can be seen from this table, NWT residents paid, on average, a lower percentage of their personal income in territorial tax than the average Canadian paid in provincial tax.

TABLE 6

	<u>Province</u>	<u>Percent</u>
1992 Effective Provincial/ Territorial Personal Income Tax Rates Average Percentage of Taxable Income	Newfoundland	7.1
	Prince Edward Island	6.4
	Nova Scotia	7.1
	New Brunswick	6.8
	Ontario	7.6
	Manitoba	7.8
	Saskatchewan	7.6
	Alberta	6.6
	British Columbia	7.1
	Yukon	6.1
	Northwest Territories	6.5
	Average	7.4

Note: Effective tax rates include the impact of flat taxes, surtaxes and tax credits.
Source: GNWT Department of Finance calculation,

A more complete comparison of NWT and provincial tax rates is provided in Appendix 5.

Why is our personal income tax rate so low?

Although our nominal and effective personal income tax rates may seem low, the income tax burden faced by NWT residents is actually comparable to provincial averages. A recent study of personal income taxation by the GNWT Department of Finance shows that due to the higher costs and higher incomes in the NWT, residents pay on average 17.2 percent of their income in Federal and territorial income tax, whereas the Canadian average on the same real income is 17.3 percent. In fact, NWT low income families may pay more, as a percentage of income, than the Canadian average. (A paper more fully explaining this difference is available on request from the NWT Department of Finance – see page 45 for address and telephone number.)

Are there any taxes the GNWT does not levy?

Two taxes which are currently charged in most other jurisdictions that are not levied in the territories are retail sales taxes and capital taxes. Retail sales taxes, which are imposed on the sale of some goods and services, are levied in all jurisdictions except Alberta, Northwest Territories and Yukon. Rates across Canada range from 6.5 percent to 12 percent.

Corporate capital taxes are levied at both the provincial and federal levels in all provinces, and are based on each company's 'taxable paid-up capital' (loosely defined as the book value of assets after subtracting current accounts payable). The capital tax rate for large corporations ranges from 0 to 0.6 percent, and the rate for financial institutions ranges from 1.12 per cent to 3.25 percent. All provinces have separate capital taxes on financial institutions. Five provinces impose a capital tax on all large corporations.

Can we significantly increase tax rates?

Tax increases could be part of a package to reduce the projected deficit. However, tax rates in the NWT should be competitive with those of other jurisdictions. For example, corporate income tax rates may influence corporate decisions on geographic location. Similarly, jurisdictional differences in taxes on items such as tobacco and liquor may lead to increased smuggling and black market activities.

What steps have been taken by the GNWT to increase tax revenues?

Over the past five years, the GNWT has increased the personal income tax rate by one percentage point and has implemented a payroll tax of one per cent (in conjunction with a cost of living tax credit). In addition, the GNWT has increased the income tax rate for large corporations by two percentage points to 14 per cent (although the small business income tax rate was decreased by three percentage points to five per cent). Tobacco tax rates were increased in 1994 to offset a reduction in the federal tax, and liquor markups have also been increased.

Can we rely on economic growth for higher revenues?

The outlook for economic growth in the NWT over the next few years is good. In 1993 and 1994, job creation in the NWT exceeded the national average. Many of these employment opportunities have been created by the direct and indirect effects of a healthy mineral exploration environment.

Because of strong job growth, personal income has remained robust in the NWT over the last two years, despite weakness in wage rates. Retail sales have been strong as well, providing much needed income for the wholesale and retail sector. Businesses providing services are also benefiting from the economic situation.

The GNWT Department of Finance anticipates that economic growth will translate into tax revenue growth of about 6.5 percent per year through 1997.

However, economic growth will not necessarily mean more revenue for the NWT. This is because an increase in the GNWT's tax bases arising from higher growth results in a lower Grant from the federal government, and can even result in a reduction in total revenues. The application of the **Tax Effort Adjustment Factor** to territorial own-source revenues means that if revenues included in the Grant calculation rise by \$1.00 as a result of economic growth, the Formula Financing Grant will be reduced by \$1.30. The only way to increase total GNWT revenues is through tax rate increases or the introduction of new taxes. (Please see Appendix 4 for a more detailed explanation.)

Tax Options

What tax options are available for the **GNWT?**

The NWT has the same tax options provincial governments have, with the exception of royalties on mining, oil and gas. Options for increasing GNWT revenues include:

- increasing the personal income tax rate
- increasing the payroll tax
- implementing a sales tax
- increasing corporate income tax rates
- imposing a corporate capital tax
- increasing tobacco and fuel taxes
- increasing property tax rates, and
- increasing the costs of fees and licences

PERSONAL INCOME TAX

How does personal income tax work?

The personal income tax is the largest single source of tax revenue for the GNWT. The tax is expected to generate \$62.6 million in 1995-96. It is levied on all individuals who declare residence in the NWT as of December 31st of the tax year in question.

Personal income taxes are levied on an individual's taxable income. In the NWT, the personal income tax rate is 45 percent of **Basic Federal Tax**.

For most people, the personal income tax is "collected at source." This means that income tax is deducted by employers before paycheques are issued. People who are self-employed or who have other sources of income are required to send their income tax directly to the federal government.

What restrictions are there on the Northwest Territories' income tax?

The NWT, Yukon, and nine of the ten provinces have **income tax collection** agreements with the federal government. These agreements ensure that:

- taxpayers only have to file one consolidated return;
- administration costs are reduced, since governments only have to process one return per taxpayer; and
- most of the rules regarding personal income taxation are the same everywhere in Canada, so all income is taxed only once by provincial or territorial governments.

In exchange for the federal government collecting provincial and territorial taxes, provinces and territories agree that:

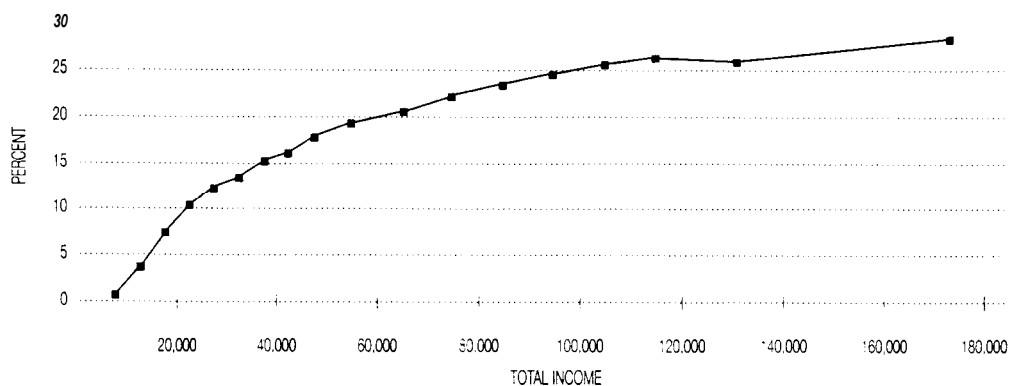
- the definition of income subject to tax, deductions from income, exemptions, non-refundable tax credits, tax brackets, and indexation factors are all determined by the federal government;
- tax on most income is paid to the province or territory of residence on December 31. Income earned in the NWT by a taxpayer resident in a province will be taxed in that province, not in the NWT;
- provincial or territorial personal income tax must be expressed as a percentage of Basic Federal Tax. Although provinces can have their own surtaxes and refundable credits, they cannot have their own deductions or exemptions. Although several provinces currently impose a flat tax on income, the federal government has stated that no other province or territory may impose a flat tax; and
- the federal rules with respect to filing deadlines, interest rates, penalties, and appeals also apply to territorial and provincial income taxes.

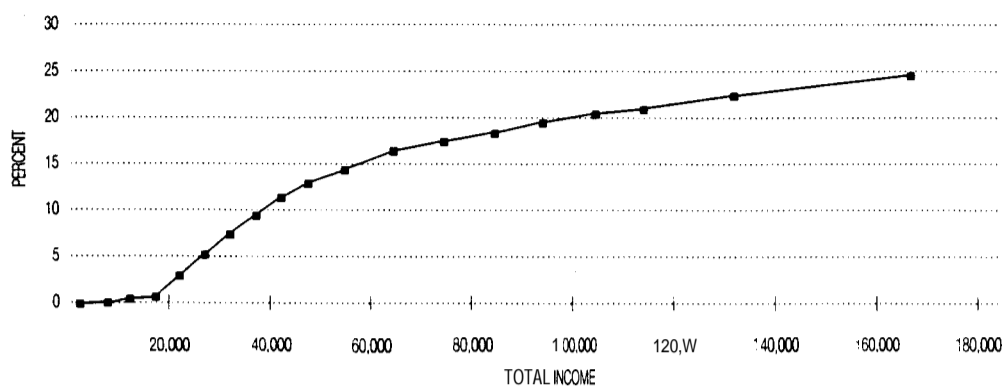
At what income level does the personal income tax hit hardest?

Typically, personal income taxes are designed to be progressive, that is, the more income a person earns, the more tax is paid, as a proportion of income. Figures 14 and 15 demonstrate how the NWT personal income tax bite increases as taxpayers earn more income.

Personal income tax can be made more progressive by imposing a high-income surtax. Surtax rates imposed in other Jurisdictions range from eight percent of provincial tax over \$13,500 in New Brunswick, to 30 percent of tax between \$5,300 and \$9,000 and 50 percent of provincial tax over \$9,000 in British Columbia. Because of the small number of taxpayers in the NWT to which a surtax would apply, a surtax imposed at the lower rates would not generate significant revenues. It is estimated that a surtax similar to New Brunswick's would generate only \$180,000 annually, A surtax similar to British Columbia's would generate as much as \$4,000,000 annually, although the higher burden might encourage higher-income taxpayers to leave the NWT.

FIGURE 14
1992 Federal and NWT Income Tax as a Percentage of Total Income Single Individuals



**FIGURE 15**

1992 Federal and NWT Income Tax as a Percentage of Total Income
Married Couples

What would be the effect of a ten percentage point increase in the personal income tax rate, from 45 percent to 55 percent?

Revenue impact:

An increase to the NWT Personal Income Tax Rate would generate \$1.6 million per year for each percentage point increase.

Economic impact:

The NWT currently has the lowest nominal tax rates in the country. Exclusive of surtaxes and flat taxes, a nominal tax rate of 55 per cent would be roughly equal to the Canadian average (excluding Quebec) of 55.6 per cent. Any increase in the income tax rate relative to other jurisdictions could discourage people from living and working in the NWT.

Administration:

Any change in rates would be implemented by Revenue Canada, at no cost to the NWT.

Would a rate increase be progressive?

Since the personal income tax is progressive, an increase to the personal income tax rate would also be progressive. Although a surtax likely would not generate a significant amount of revenue, it would make our personal income tax more progressive,

PAYROLL TAX

What is a payroll tax?

A payroll tax is a tax levied on wages and salaries. It is paid either by the employer or by the employee, and deducted from the employee's pay-cheque. Some payroll taxes are earmarked for particular uses. For example, the federal government levies payroll taxes to support the Canada Pension Plan and the unemployment insurance system,

What provinces have payroll taxes?

Currently, four provinces (Quebec, Manitoba, Ontario, and Newfoundland) levy payroll taxes, at rates ranging from 1.95% to 4.26%. In contrast to the NWT payroll tax, which is deducted from employee paycheques, the provincial payroll taxes are all levied on employers and are based on employers' total payrolls above a certain threshold.

How does the NWT payroll tax work?

The NWT Payroll Tax is levied on all employees at the rate of one percent of all wages and salaries and the monetary value of all benefits, taxable allowances, bonuses and commissions. However, it is not levied on any income from sources other than employment.

The payroll tax was introduced in 1993 as a means to raise revenue and to tax the income of workers who earn wages in the NWT, but pay income tax to some other province. It has been estimated that between \$150 and \$200 million in salaries and wages earned in the NWT are not declared here on personal income tax returns because workers live elsewhere. The NWT payroll tax is a way of ensuring that these individuals pay some tax to the NWT to fund the benefits they receive from territorial services.

How much revenue does the NWT Payroll Tax generate?

The payroll tax generated about \$11.8 million in 1994-95, and is expected to generate \$12.4 million in 1995-96.

If the rate was increased from one percent to two percent, the current payroll tax could generate an additional \$12.4 million annually. This figure assumes that the increase would not have a significant effect on employment in the NWT. Raising the payroll tax from one percent to two percent would not significantly affect administration and collection costs.

SALES TAX

What is a sales tax?

A sales tax is a tax on the sale of goods and services. There are two basic types of sales tax. A retail sales tax is levied on consumer and business purchases, usually at the retail level. The tax may also apply to goods purchased or manufactured by a business, which are used by the business. The retail sales tax does not apply to goods purchased by a business for resale. Since businesses pay tax on some of the goods they use, this tax may be passed on to consumers through higher prices. Nine provinces have sales taxes.

In contrast to a retail sales tax, a value-added tax (such as the federal Goods and Services Tax (**GST**)), is levied on the value added at each stage of the production process. Businesses charge the tax on the value of their taxable sales, but receive credits for tax that they pay on their purchases. Because all tax paid by businesses is refunded or credited, the only tax paid by the consumer is the tax charged on the final sale.

What methods of implementing a sales tax are there?

Retail Sales Tax

The GNWT could impose its own retail sales tax. What would be taxed and at what rate would be decided by the GNWT. It is estimated that a seven percent sales tax, imposed on a base similar to that used by the provinces, could raise about \$40- 45 million annually. However, there would be significant administrative and compliance costs associated with having a separate and distinct retail sales tax. It should be noted that this estimate of the revenue yield of a sales tax could vary considerably, depending on the exemptions offered.

There are two methods of implementing a value-added tax,

NWT GST

Although it would be constitutionally possible for the GNWT to levy its own separate retail sales tax, there would be significant advantages (such as the reduction in individual and business compliance costs) to adding a territorial sales tax component to the federal GST. Like the GST, the tax would apply to all goods and services (with some exemptions, such as basic groceries). Eligible businesses would be able to claim a credit for sales tax paid on their purchases, which would remove the tax from all business inputs. An NWT GST could have lower government administration costs than a straight retail sales tax, if the tax were administered by the federal government. It would present some administrative problems, since businesses would have to track purchases and sales geographically, to ensure that input tax credits were only requested on purchases which had been taxed.

Integrated Sales Tax

A third option exists under the recent federal proposal to co-ordinate the GST and all existing provincial retail sales into one single sales tax. This integrated sales tax (IST) would be levied at one rate everywhere in Canada, with revenues shared between the federal and provincial/territorial governments. The tax would be administered by the federal government. However, this option would require agreement by most of the provinces.

What do other jurisdictions do?

All provinces, with the exception of Alberta, levy a retail sales tax, at rates from 6.5 percent in Quebec to 12 percent in Newfoundland. Services often are exempt from the tax, and numerous other exemptions are permitted.

Only Quebec has partially "harmonized" its sales tax with the federal GST. Quebec taxes the same goods and services, with the same exemptions as the GST. Both the provincial sales tax and the GST are administered by the Quebec government. By the end of 1996, Quebec will offer full input tax credits on the same basis as the federal government.

Why does the Northwest Territories not have a sales tax?

A sales tax would increase the already high cost of living in the north. The burden would be greater in more remote communities where prices are higher.

Because prices are already high in the NWT, and to help avoid increasing prices, the government has put off introducing a sales tax.

Aren't sales taxes more regressive than most other taxes?

Studies in other jurisdictions have shown that a sales tax is regressive, that is, low-income individuals pay a greater proportion of income with this tax than do those with higher incomes. A refundable sales tax credit for low-income individuals and exemptions for certain expenditures (such as food) can offset this aspect of the tax.

In the NWT, a refundable credit, similar to the federal GST credit, could be provided to low income individuals and families. Depending on how generous the credit was, the cost could range from \$6 million to \$10 million in lost revenues.

How much revenue could a sales tax generate?

A territorial sales tax, imposed on the federal GST base, could raise about 5.5 million to 6.5 million for every percentage point of tax. A sales tax credit, similar to the federal GST credit, could cost from \$6 million to \$10 million.

FUEL TAXES

A one percentage point increase to the Gasoline Tax, with corresponding increases to other fuel taxes, could raise close to \$750,000 annually. Northwest Territories fuel taxes are lower than those of other Canadian jurisdictions, with the exception of Alberta and Yukon.

Fuel taxes apply to gasoline, aviation fuel, diesel fuel used in motor vehicles and other diesel fuel. Gasoline purchased in communities not on the highway system is taxed at a reduced rate -60 percent of the on-highway rate. Heating fuel is exempt from tax.

A tax increase would affect transportation costs throughout the NWT. It would also affect the cost of electricity in areas where it is supplied by diesel-powered generators.

TOBACCO TAXES

Taxes on tobacco in the NWT are higher than those in any province except Newfoundland. (Newfoundland imposes a tobacco tax and a 12 percent sales tax on tobacco products.) A rate increase could, in addition to providing increased revenue, assist in reducing health problems associated with smoking in the NWT. An increase in tobacco taxes would help to reduce consumption. In the past, the revenue lost as a result of reduced consumption was less than the revenue gained due to an increase in taxes.

A number of provinces have reported significant increases in smuggling over the past few years as Canadian tobacco taxes have increased. To date, NWT revenues do not seem to have been significantly affected.

A one percentage point increase in the tobacco tax would raise about \$180,000 a year.

CORPORATE INCOME TAXES

How is the Corporate Income Tax structured?

Large corporations operating in the NWT pay a corporate income tax of 14 percent. A lower rate of five percent applies to small businesses with incomes of \$200,000 or less.

This tax is administered by Revenue Canada. The NWT has agreed to use the same base as the federal government for its corporate income tax.

How much revenue would an increase in corporate income tax bring in?

An increase in the Corporate Income Tax rate for large corporations could raise about \$2,000,000 annually for each percentage point increase.

Quebec is the only jurisdiction with a Corporate Income Tax rate lower than that of the NWT, although Quebec has a higher tax rate for investment income and also has a capital tax.

Because the NWT rate is lower than that in most provinces, there is an incentive for corporations to structure their business so their income is allocated to the NWT. Our

recent rate increase to 14 percent has reduced the incentive for companies to do this. The NWT rate is now only slightly less than the average Canadian rate.

Because there is a very limited range of businesses in the NWT, government corporate tax revenues are heavily dependent on factors which affect just a few businesses. For example, if some of the larger resource companies operating in the NWT experience a variation in income, this could have a significant impact on government tax revenues. It is very difficult to accurately forecast revenues. Any projected increase in revenues from a new tax rate might not materialize.

An increase in the corporate income tax rate charged to small business from five percent to six percent would raise an estimated \$250,000 annually. The rate was reduced from eight per cent effective July 1, 1991, and since that time a number of other jurisdictions have also lowered their rates for this type of business.

Economic Impact

Higher NWT taxes might cause some businesses to discontinue, or scale back, operations in the NWT.

A higher NWT corporate income tax rate might prompt some large corporations to transfer some income to other provinces or countries. There are a number of ways corporations can shift income without affecting operations. In addition, there would be less incentive for corporations to shift income into the NWT, since five other jurisdictions charge a similar rate. Newfoundland's corporate rate is now 14 percent, two other jurisdictions currently have a 15 percent rate and two charge 15.5 percent.

Increases in corporate taxes will ultimately be passed on to individuals - employees, customers, owners, or suppliers. Many of these individuals, however, may not be residents of the NWT.

CORPORATE CAPITAL TAX

How much revenue could a capital tax generate in the Northwest Territories?

A Corporate Capital Tax with rates similar to those levied in the provinces (0.3 percent, with a higher rate of 1.2 percent for financial institutions) could raise up to \$6 million annually. Most of the tax would be paid by the mining and oil companies operating in the NW. The revenue estimate of \$6 million is very rough, as reliable data on the capital employed in the NWT does not exist.

Why would the government impose a capital tax rather than higher corporate income taxes?

Some large corporations may not pay income tax in the NWT. A capital tax is payable whether or not a corporation has taxable income. A capital tax would allow the government to collect some revenue from corporations which have no income, or those which use provisions of the Income Tax Act to avoid or postpone paying income taxes.

Businesses have opposed capital taxes because they are not related to profits. Companies have to pay capital taxes whether or not they make money, so even when a company is doing poorly, it may have to pay substantial capital taxes.

INSURANCE TAX

The insurance tax is a tax on insurance companies operating in the NWT at a rate of three percent of premiums. An additional one percent is imposed on fire insurance premiums. The NWT Insurance Act was recently amended to increase the tax on general insurance premiums from two percent to three percent.

It is estimated that an additional \$500,000 annually would be raised by increasing the tax on general insurance premiums from three percent to four percent, and on fire insurance premiums from four percent to five percent.

PROPERTY TAXES

How do property taxes vary between communities?

Property taxes vary considerably between tax-based municipalities, which levy their own property taxes, and the General Taxation Area (Hamlets, Settlements and unorganized areas), where all property taxes are levied by the GNWT. Table 7 compares residential property taxes in different NWT communities,

Why are property taxes much higher in some communities?

Property tax rates are generally higher in communities that receive higher levels of municipal and educational services. Property taxes in the general taxation areas are much lower than those in tax-based municipalities. A large proportion of spending in non-tax-based municipalities is financed by the GNWT.

In Yellowknife, property taxes are levied by local authorities. General property taxes are used to finance municipal services. Education taxes are used to finance a portion of local school board expenditures.

Fort Smith, Hay River, Fort Simpson, Norman Wells, Inuvik and Iqaluit levy their own general property taxes to finance municipal services. The GNWT levies the education tax but the revenues raised do not cover local education expenditures.

TABLE 7

Average Tax
on a
Single Family
Home . 1994
(Non-mobile Homes)

Tax Based Communities	Average Assessment	Mill Rate ⁽¹⁾	Average Tax
Fort Simpson	\$38,561	27.638	\$1,066
Fort Smith	\$42,630	30.480	\$1,299
Hay River	\$54,971	23.030	\$1,208
Inuvik	\$86,773	21.210	\$1,840
Iqaluit	\$49,159	33.640	\$1,654
Norman Wells ⁽²⁾	\$49,860	13.040	\$ 650
Yellowknife ⁽²⁾	\$101,346	23,600	\$2,392

Note:

⁽¹⁾ Because different municipalities use different assessment base years, **mill rates** (the tax rate expressed as dollars per thousand dollars of the assessed value of land and improvements) alone are not a sufficient indicator of tax burden.

⁽²⁾ Assessments and mill rates in Norman Wells and Yellowknife will change significantly in 1995 as a result of general reassessments.

General Taxation Area - Selected Communities	Average Assessment	Mill Rate	Average Tax
Cambridge Bay	\$33,109	6.60	\$219
Fort McPherson	\$25,965	6.60	\$171
Pangnirtung	\$29,058	6.60	\$192
Rae	\$39,547	6.60	\$261
Rankin Inlet	\$30,559	6.60	\$202

In the General Taxation Area, property and school taxes are levied by the GNWT. These tax revenues are allocated to general revenue and are not related to municipal or educational expenditures. Property tax rates are lower in the General Taxation Area in recognition of the fact that residents receive fewer municipal services than in tax-based municipalities.

What other consultations are taking place regarding property taxes?

The GNWT is reviewing NWT property taxes to explore possible alternatives to the Property tax as a means of financing local government and education. This project was initiated in response to objections made by some NWT residents to the principle of the property tax. Meetings are being held between representatives of municipalities, local school boards and the GNWT. Later this year, a report will be submitted to the Minister of Finance.

How much revenue could be raised with property tax increases?

An increase in property tax rates could raise about \$55,000 annually for each percentage point increase.

LIQUOR REVENUES

Higher liquor prices, in addition to providing increased revenue, may assist in reducing the consumption of alcohol and the health and social problems associated with drinking in the NWT. However, average liquor markups increased by seven percent on April 1, 1995, as a result of the flat charge initiative. For most popular liquor products, NWT prices are now about the highest in Canada.

Increasing the government's margin on liquor products would generate an estimated \$50,000 annually for each percentage point increase.

FEES AND LICENCES

How much revenue does the Government raise from fees and **licences?**

The GNWT, like all governments, earns revenues from a wide variety of fees for services. In the year ending March 31, 1995, about \$8 million was collected from various fees, including vehicle registrations, drivers licences, liquor licences, fines and hunting licences. As a result of a number of fee increases, revenues are projected to grow to over \$9 million in 1995-96.

Some fees are set to cover the cost of providing the services associated with the fee, such as fees for inspections. Others, such as library fines, do not cover the cost of the services provided but are intended to encourage certain behaviour. Still others confer a privilege or special benefit, such as drivers licences. Fees such as liquor licences or vehicle registrations might bring substantially more revenue to the government than the direct costs to collect or administer the licences. Although there is no direct connection between the fees and related costs, revenues help defray other costs such as highway maintenance, or social and medical costs associated with alcohol.

RESOURCE REVENUES

What are resource revenues?

Resource revenues include royalties, crown charges (for example, fees for the use of crown (government) land) and taxes on mining income not levied on other industries. In the NWT resource revenues on mining and oil and gas are paid to the federal government. The GNWT receives revenue from forestry operations. Currently the federal government receives revenues from oil and gas and mining production.

How much is collected annually in resource revenues?

The federal government currently collects about \$12 million annually in resource royalties from mining and oil and gas in the NWT. In addition, the federal government receives about \$40 million from its Crown share of the Norman Wells oil field profits.

At current royalty rates, the federal government could eventually collect close to \$30 million a year on production from a new diamond mine, although revenues could be much lower for the first five to ten years.

Could resource revenues be used to resolve the **NWT's** deficit problem?

The right to collect royalties on mineral development could be transferred to the NWT from the federal government under a possible Northern Accord. Although these revenues would be offset with a reduction to the grant, the GNWT would still achieve a position of greater self sufficiency.

If this scenario is accurate, a significant portion of any new GNWT revenues from future mineral development would go to the federal government, because the Formula Financing Grant would be reduced as GNWT revenues increase.

While the transfer of responsibility for non-renewable resources from the federal government and/or new mineral development have potential to increase GNWT tax revenues, it is unlikely that total GNWT tax revenues would begin to match total spending of \$1.2 billion annually. In addition, even if the GNWT could capture some of this revenue, because of the length of time it takes to get a large non-renewable resource project going and for it to start earning income, the GNWT would not benefit before 1999.

Resource revenue sharing is not an option which will solve the deficit reduction needs of the GNWT in 1996.

Revenue Impact of tax increases

How much revenue could tax increases generate?

Table 8 summarizes the potential revenue from tax rate changes.

Tax	Current Rate	Possible Increase	Annual Revenue
Personal Income Tax	45% of BFT	1%	\$1,600,000
Personal Income Tax Surtax	none	8% of tax over \$13,500 30% of tax over \$5,300, + 2070 of tax over \$9,000	\$180,000 \$4,000,000
Corporate Income Tax (Large)	1% of CTI	1%	\$2,000,000
Corporate Income Tax (Small)	5% of CTI	1%	\$250,000
Capital Tax	none	0.3% of capital	\$6,000,000
Sales Tax	none	1%	\$5.5 million to \$6.5 million
Integration of Sales Tax with GST		1%	\$5,500,000 to \$6,500,000
GST credit	none	Similar to federal	<\$6,000,000 to \$10,000,000>
Fuel Tax — Gasoline	17% of price	1%	\$750,000
Fuel Tax — Aviation Gasoline	1.0 cents	0.1 cents	
Payroll Tax	1% of earnings	1%	\$12,400,000
Tobacco Tax	90% of price	1%	\$170,000
Property Tax	var. rates	1%	\$55,000
Liquor	132 to 218%	1%	\$50,000

Note: Increases to existing taxes could be implemented soon after passage of the appropriate legislation. New taxes would require up to a year or more after introduction in order to set up the necessary administration.

TABLE 8

Annual Revenue
from Possible
Tax Options

Consultation

The Minister of Finance is committed to consulting with NWT organizations and residents on the changes needed to balance the budget in 1996-97. This consultation will provide northern residents with the opportunity to voice their opinions and preferences about the tax and expenditure reduction options that the GNWT must consider if it is to eliminate the deficit.

People need relevant and accessible background information in order to feel comfortable about participating in this process. This is challenging, because different people have different levels of understanding about what government is, how it works, and how it can influence the economic and social life of the NWT.

This discussion paper is part of the consultation process. It provides background on the facts, issues and options associated with eliminating the GNWT deficit. It provides information on:

- the current fiscal position of the GNWT, as well as some projections for the future;
- where the GNWT currently spends its money and the nature of the spending pressures facing the GNWT;
- various approaches to reducing expenditures as well as an assessment of their potential effectiveness;
- the sources of the GNWT'S tax revenues and the potential for growth; and
- options for increasing NWT taxes.

Public meetings will be held in each region. A presentation by Department of Finance and Financial Management Board Secretariat staff will be followed by general discussion.

Some of the questions that the GNWT will be addressing through this public consultation process include:

- Should measures to eliminate the deficit be focused more on reducing expenditures and programs, or on increasing taxes?
- What programs or expenditures should be cut or scaled back?
- What program areas should be cut less than others?
- What options should the GNWT pursue to raise additional revenues?
- Which government services should people pay for directly, or share in the cost?

The government would like your views on these questions.

Your questions, comments and concerns relating to the elimination of the GNWT deficit are important. If you wish to air your views, obtain further information, or provide specific suggestions on what the GNWT should or should not do about spending and taxation, please write to:

The Minister of Finance
Government of the Northwest Territories
Legislative Assembly
P. O. Box 1320
YELLOWKNIFE NT XI A 2L9
or call or fax:
1-800-661-0874

APPENDIX 1

(\$000s)

GNWT

Expenditures
1995-96

Payments to Persons		
Social Assistance		29,351
Employee Benefits		18,603
Student Grants		10,237
Power Subsidy Program		4,407
Property Tax Rebate Programs		1,155
Fur Price Program		595
Criminal Injuries Compensation		65
Other		160
Total Payments to Persons		<u>64,573</u>
Payments on Behalf of Persons		
Medical Care		18,301
Non-Insured Health Benefits		16,622
Medical Transportation		16,134
Out-Of-Territories Hospitals		16,108
Residential Care Elders and Handicapped		6,679
Extended and Chronic Care		3,587
Foster Care		3,180
Supplementary Health Benefits		2,237
Seniors' Supplementary Benefits		2,216
Residential Care for Children		2,018
Children's Group Home		1,751
Home Care Support		859
Intervention Services		583
Services to Elders and Handicapped		520
Family Counseling		101
Transportation Assistance Program		43
Total Payment on Behalf of Persons		<u>90,939</u>
Payments to Organizations/Other Levels of Government by Department (Appendix 3 details Grants & Contributions)		
Education, Culture & Employment		180,247
Health & Social Services		117,979
Housing Corporation		62,035
Municipal & Community Affairs		52,116
Justice		31,599
Economic Development & Tourism		15,255
Renewable Resources		5,021
Energy, Mines & Petroleum Resources		1,225
Executive Offices		1,248
Ministry of Intergovernmental & Aboriginal Affairs		950
Transportation		14
Total Payment to Organizations/Other Levels of Government		<u>467,689</u>

	(\$000s)
Direct Spending by Government Departments	
Public Works and Services	
Building and Vehicle Maintenance'	28,659
Leases	35,587
Utilities	24,603
Other Salaries	20,469
Other Direct Spending	11,461
Total	<u>120,779</u>
Transportation	
Ferry Operation and Maintenance'	3,646
Highway Maintenance Operations *	16,501
Other Salaries	11,162
Other Direct Spending	15,184
Total	<u>46,493</u>
Renewable Resources	
Forest Fire Fighting and Prevention"	22,471
Other Salaries	14,522
Other Direct Spending	5,463
Total	<u>42,456</u>
Justice	
Corrections'	20,424
Court Services *	8,891
Other Salaries	4,227
Other Direct Spending	3,947
Total	<u>37,489</u>
Education, Culture and Employment	
Salaries	17,618
Other Direct Spending	13,154
Total	<u>30,772</u>
Health and Social Services	
Salaries	20,664
Other Direct Spending	6,597
Total	<u>27,261</u>
Economic Development and Tourism	
Salaries	11,096
Other Direct Spending	7,907
Total	<u>19,003</u>
Financial Management Board Secretariat	
Salaries	13,667
Other Direct Spending	4,520
Total	<u>18,187</u>

APPENDIX 1

Continued

' Includes salaries

APPENDIX 1
Continued

	(s000s)
Municipal and Community Affairs	
Salaries	9,633
Other Direct Spending	<u>5,069</u>
Total	<u>14,702</u>
Executive Offices	
Salaries	7,443
Other Direct Spending	<u>2,148</u>
Total	<u>9,591</u>
Legislative Assembly	
Salaries	4,433
Other Direct Spending	<u>4,924</u>
Total	<u>9,357</u>
Safety and Public Services	
Salaries	5,354
Other Direct Spending	<u>1,877</u>
Total	<u>7,231</u>
Finance	
Insurance Premiums	1,776
Interest Payments	1,902
Salaries	2,666
Other Direct Spending	<u>755</u>
Total	<u>7,099</u>
Energy, Mines & Petroleum Resources	
Salaries	2,265
Other Direct Spending	<u>2,197</u>
Total	<u>4,462</u>
Personnel Secretariat	
Salaries	2,697
Other Direct Spending	<u>1,440</u>
Total	<u>4,137</u>
Ministry of Intergovernmental and Aboriginal Affairs	
Salaries	2,230
Other Direct Spending	<u>1,035</u>
Total	<u>3,265</u>
Total Direct O&M Spending	<u>402,284</u>
Total O&M	<u>\$1,025,485</u>

	(\$000s)
Capital	
Direct Capital Spending by Government Department	
Public Works and Services	12,685
Transportation	36,034
Renewable Resources	2,471
Justice	154
Education, Culture and Employment	26,171
Health and Social Services	8,026
Economic Development and Tourism	3,469
Municipal and Community Affairs	28,351
NWT Housing Corporation	49,000
Legislative Assembly	230
Safety and Public Services	185
Total Direct Capital Spending	<u>166,776</u>
Community Contributions - Transportation	270
Community Contributions - Municipal and Community Affairs	11,393
Community Contributions - Health and Social Services	2,377
Community Contributions - Economic Development and Tourism	4,901
Community Contributions - Education, Culture and Employment	8,940
Total Payments to Organizations/ Other Levels of Government for Capital Purposes	<u>27,881</u>
TOTAL CAPITAL EXPENDITURES	<u>194,727</u>
TOTAL EXPENDITURES	<u>\$1,220,142</u>

APPENDIX 1
Continued

APPENDIX 2

**Summary of
Employee Salary
and Benefits
1994
Calendar Year
Including Boards
and Agencies**

<hr/>	
Salary	
Base Salary and Wages	\$316,284,217
Overtime	8,923,990
Teacher Allowances	1,096,471
Call-Back Pay	1,035,183
Standby Pay	902,047
Miscellaneous Pay	1,007,605
Shift Premium	607,082
Total	\$329,856,595
<hr/>	
Allowances	
Accommodation Allowance	29,600,342
Settlement Allowance	15,329,430
Household Allowance	1,336,962
Bilingual Bonus	131,662
Education Allowance	866,527
Total	\$ 47,264,923
<hr/>	
Pension and Health Care	
Superannuation	17,430,405
Unemployment Insurance	10,257,224
Canada Pension Plan	5,849,536
Disability Insurance	2,450,509
Workers' Compensation	2,729,922
Dental Plan	2,023,668
Public Service Health Care Plan	1,768,983
Supplementary Unemployment Benefits (Maternity)	1,137,267
Public Service Management Ins. Plan (Disability)	830,320
Total	\$ 44,477,834
<hr/>	
Other Benefits	
Vacation Travel Assistance	19,002,713
Medical Travel Assistance	4,126,489
Removal In	3,461,440
Removal Out	2,300,216
Severance Pay	3,681,089
Removal Transfer	124,542
Storage	842,960
Other	84,000
Total	\$ 33,623,449
<hr/>	
TOTAL COST	\$455,222,801
<hr/>	

APPENDIX 2

	Number of Positions	Percentage of Total
Health Care		
Hospital Nurses	225	
Community Nurses	169	
Hospital Support Services	391	
Nursing Support	46	
Technical Services	72	
Physicians	16	
Rehabilitation Services	14	
Dental Therapists and Officers	9	
Other	10	
Total Health Care	952	13.6%
Education		
Teachers	1,112	
Educators	188	
Classroom Assistants	148	
Trainees	55	
Apprentices	46	
Administration	31	
Total Education	1,580	22.7%
Other Program Delivery		
Individual Services	250	
Development Services	166	
Corrections Officers	114	
Economic Services	114	
Wildlife Officers	83	
Interpreting Services	61	
Child Care	57	
Local Government Services	35	
Other	69	
Total Other Program Delivery	949	13.60%
Administrative Services		
Secretarial and Clerical	1,014	
Management	349	
Planning and Evaluation	313	
General Administration	226	
Financial and Audit	178	
Property Management and Purchasing	57	
Human Resources	85	
Judges, Legal and Courts	36	
MLAs and Assistants	42	
Total Administrative Services	2,300	32.9%
Technical	507	7.3%
Trades	388	5.6%
General Labour	303	4.3%
TOTAL	6,979	100.00%

**Breakdown of
GNWT Personnel**
by Job Category
Including Boards
and Agencies

APPENDIX 3

**GNWT Grants
and
Contributions**
1SS6 -96

Program	Amount (\$000s)
Education Authority Contributions	140,106
Health & Hospital Boards	93,785
NWT Housing Corporation	62,035
College Contributions	28,158
Hamlet Transfer Payments	24,324
Student Grants	10,237
Water and Sewer Subsidy Program (Hamlets/Tax-based)	9,759
Economic Development Agreement	7,943
Investing in People	6,000
Community Programs-Operating	4,533
Power Support Program	4,407
Treatment Centres	4,244
Block Funding - Yellowknife	4,100
Payment in Lieu of Taxes	3,724
Recreation Facilities	3,691
Community Wellness	3,501
Town of Iqaluit	3,394
Programs for Elders and the Physically and/or Mentally Challenged	3,265
Business Development Fund	3,264
Nunavut Hunter Income Support Trust Fund	3,000
Recreation Leaders Salary Subsidy	2,730
Family Violence Prevention Services	2,547
Municipal Equalization Payment	2,417
Community Teacher Education Program	1,540
Legal Aid Clinics	1,440
NWT Development Corporation	1,344
Early Childhood Program	1,238
Minerals Initiative Program	1,060
Homeowners' Property Tax Rebate	1,000
Community Justice Contributions	918
Community Harvester Assistance Program	817
Local Wildlife Committees	769
Mackenzie Court Workers	704
Commercial Fisheries	672
Regional Councils	661
Community Transfer Initiatives - Health	638
Fur Price Program	595
Non-Profit Organizations	541
NWTTA Professional Improvement Fund	526
Community Transfers - EDO	524
Community Transfer /Self Government Contributions	500
Prevention of Child Sexual Abuse	200
Youth Initiatives	437
Small Business Grants	420
NWT Tourism Industry Zone Association	416
Women's Initiative Grants/Contributions	412
Community Library Services	355
Business Credit Corporation	322
Core Funding - Economic Development Organizations	300
Cultural Organizations	275
Metis Nation Grant	250
Summer Pool Operating Program	241
Sport North	225
Literacy Funding	221
Regional Wildlife Organizations	217
Recreation Administration	216
NWT Arts Council	214
Youth Initiatives Grant	200

Program	Amount (\$000s)
Aboriginal Organizations Contributions	200
Intercommunity Sport Competition Program	197
Community Museums	191
Native Women's Association	175
Victims Assistance Contributions	170
Dene and Inuit Games	165
Senior Citizens and Disabled Property Tax Rebate	155
Community Broadcasting	151
NWT Regional Winter Games	146
Wildlife Management Boards	128
Native Communications	105
Cultural Enhancement	101
Family Counseling	101
Northern Accord Contributions	100
Tree of Peace	100
Arctic Public Legal Education and Information Society	90
Foster Parents Association	90
Oral Traditions	84
Northern Performers	83
NWT Association of Municipalities/Municipal Administrators	76
Suicide Prevention	73
Labour Pools	67
Project Change School	60
Community Organized Hunts	57
Group Liability Insurance Plan - Storefront	50
Forest Industry Assistance	50
Physicians Professional Development	50
NWT Sport Development Staff Program	49
Development Impact Zones	40
Aboriginal Court Challenge	40
Support to Settlements	36
Support to Fur Industry	33
NWT Ski Program	30
Canadian Energy Research Institute	25
University of Alberta	20
Disaster Compensation	15
Community Access Roads	14
NWT Association of Fire Chiefs and Fire Fighters	10
Sport Organizations	10
Youth Business Works	10
Humane Trap Development	5
Uniform Law Conference	3
Canadian Association of Provincial Court Judges	3
Total Grants and Contributions	\$454,930

APPENDIX 3

Continued

APPENDIX 4

FORMULA
FINANCING

Since 1985-86, the NWT has received cash transfers from the federal government under a formula financing arrangement. Before that, a yearly grant was determined through negotiations with the federal government.

How is the Grant calculated?

The Formula Financing Agreement between the GNWT and the Government of Canada forms the basis for calculating the Grant from Canada, which represents about **75 per cent of the GNWT's revenues. The most recent Agreement covered the period from 1990-91 to 1994-95, inclusive. Discussions for the 1995-1999 period are under-way.**

The Grant from Canada is forecast to be \$883 million in 1994-95.

The principle behind the Formula Financing Agreement is similar to that underlying the federal-provincial Equalization program - that less-well-off jurisdictions should receive funding to allow them to provide "reasonably comparable levels of public services at reasonably comparable levels of taxation." The GNWT does not participate in Equalization because the current formula for determining entitlements does not take into account the very high per capita expenditure requirements of this government.

The formula used to calculate the Grant from Canada has the following basic structure:

GROSS EXPENDITURE BASE - ELIGIBLE REVENUES = GRANT FROM CANADA

The Gross Expenditure Base (GEB) is an approximation of the GNWT's expenditure needs. However, it does not equal the Government's actual expenditures.

Eligible Revenues are an approximation of the GNWT's ability to raise revenues from sources other than the Grant. They do not equal actual revenues.

The Grant represents the difference between the GNWT's expenditure needs and its revenue raising capacity.

There are many variables which enter the calculation of both of these elements. The GEB was established as a fixed amount and escalated annually. The escalator is based on the annual growth in national provincial and local (P-L) government spending. However, it is subject to a ceiling based on the growth of national Gross Domestic Product (GDP). The escalator includes an adjustment for the difference in population growth rates between the NWT and Canada.

The GEB is also adjusted when program responsibilities are transferred from the federal government, as was the case with forestry management in 1986 and health care in 1988.

The GNWT's expenditure needs, therefore, are deemed to grow at approximately the same rate as those of the provinces and local governments, adjusted for different population growth rates. However, the GDP ceiling prevents the GEB from growing faster than the Canadian economy.

Eligible revenues include "hypothetical" own-source revenues and recoveries, transfer payments from Canada, and other revenues and recoveries. "Hypothetical" revenues refer to tax and other revenues which are calculated using rates in effect in 1987-88. That is, they are the revenues that would hypothetically be collected if the GNWT still had the tax rates that were in effect in 1987-88.

This means that revenue increases which result from volume changes are offset by decreases in the Grant, and vice versa. It also means that revenue increases which result from tax rate increases do not decrease the grant, but accrue to the benefit of the GNWT.

Under the current Formula Financing Agreement, hypothetical revenues are adjusted for the GNWT's relative "tax effort". The GNWT's relative "tax effort" is a measure of tax rates imposed by the GNWT compared to those imposed by other Canadian provinces and municipalities. There are two tax effort adjustment factors. The "catch-up" factor compares the tax effort of the GNWT with the provinces in 1987-88. The "keep-up" measures the change in provincial tax effort since 1987-88.

These adjustment factors are used to gross-up hypothetical revenues, and thereby decrease the grant. These factors were imposed by the federal government, and have the effect of penalizing the GNWT financially for having a perceived below-average tax effort, and for not keeping pace with the growth of provincial tax effort.

The following table shows how the Grant for 1993-94 was calculated:

E X A M P L E

\$000s

Formula Financing Grant Calculation 1993-94	1992-93 (Previous Year) Gross Expenditure Base	1,041,835
	Times: The lesser of:	
	i) growth in provincial-local government spending (4.72%), or	
	ii) growth in nominal national Gross Domestic Product (2.42%)	<u>1.0242</u>
	Equals:	1,067,047
	Times: the differential growth rate between the populations of the NWT and Canada (0.78%)	<u>1.0078</u>
	Equals: 1993-94 (Current Year) Gross Expenditure Base	1,075,370
	Less: Eligible Revenues	
	i) Transfer Payments from Canada	57,486
	ii) Hypothetical own-source revenues subject to adjustment	129,696
	Times: Tax Effort Adjustment Factor	<u>1.2743</u>
	Equals: Adjusted revenues	165,272
	iii) Unadjusted hypothetical own-source revenues	550
	iv) Other eligible own-source revenues and recoveries	<u>6,949</u>
	Total Eligible Revenues	<u>230,257</u>
	Equals: Grant from Canada -1990-91 Entitlement	845,113
	Plus: Adjustment for Prior Years' Entitlements	<u>3,940</u>
	Total Grant from Canada 1993-94	<u>\$849,053</u>

Why doesn't a stronger economy mean more revenue for the government?

In most years, the **Grant from Canada is reduced by an amount equal to revenues at 1987-88 tax rates, multiplied by a tax effort adjustment factor. In 1994-95 this tax effort adjustment factor was 1.30. For every dollar in taxes (at 1987-88 rates) collected by the NWT government that enters into the Formula, \$1.30 was taken off the grant** in 1994-95.

For 1995-96 only, because the Grant is frozen at 1994-95 levels, additional tax revenues will not result in a reduction to the Grant.

What changes are being made to the Formula Financing Agreement?

The last Agreement expired March 31, 1995. A new Agreement must be entered into for the 1995 to 1999 period. The federal Minister of Finance, in his 1995 budget, announced that the Grant entitlements will be frozen in 1995-96 at the 1994-95 level and the GEB will be reduced by 5 per cent in 1996-97. Together, these measures will cost the GNWT \$200 million over the next four years. Previous measures imposed by the federal government in 1990, namely the Tax Effort Adjustment Factor and the GDP ceiling, have already cost the GNWT more than \$540 million in lost revenues over the past five years.

Provincial and Territorial Tax Rates
as of July 1, 1995

	Personal Income Tax	Retail Sales Tax	Gasoline	Fuel Tax Diesel	Aviation	Tobacco Tax Cigarettes	Tobacco	Annual Health Care	Payroll Tax	Corporate Income Tax		Capital Tax
	% of federal tax	%	¢/litre	¢/litre	¢/litre	\$/carton	¢/gram	(q) \$	(r) (%)	Small (%)	Large (%)	(s) (%)
Northwest Territories	45		10.5 (m)	8.9	1.0	24.80	9.20		1.00	5	14	
Yukon	50 (b)		6.2	7.2	1.1	16.40	2.92			6	15	
British Columbia	52.5 (C)	7	11.0	11.5	3.0	22.00	8.40	432/864		10	16.5	0.3/3.0
Alberta	45.5 (d)		9.0	90	5.0	14.00	4.00	408/816		6	15.5	0.0/2.0
Saskatchewan	50 (e)	9	15.0	15.0	3.5	16.00	5.30			8.0	17	0.6/3.25
Manitoba	52 (f)	7	11.5	10.9	4.2	16.00	5.30		2.25	9.0	17	0.3/3.0
Ontario	58 (g)	8	14.7	14.3	2.7	4.00	1.70		1.95	9.5	15.5	0.3/1.12
Quebec	N/A (h)	6.5	15.2 (n)	13.3	3.0	4.36	0.72		4.26	5.75	8.90	0.64/1.12
New Brunswick	64 (i)	11	10.7	137	2.5	6.60	2.48			7	17	0.0/3.0
Nova Scotia	59.5 (j)	11	13.5	154	0.8	6.60	5.25			5	16	0.0/3.0
Prince Edward Island	59.5 (k)	10	12.0	12.5	0.7	11.35	3.01			7.5	15	0.0/3.0
Newfoundland	69	12	16.5 (n)	16.5	0.7	20.56	6.85		2.00	5	14	0.0/3.0
Canadian Average (a)	55.4 (1)	7.0	13.6	13.1	3.0	8.74	3.04		1.92	7.9	14.1	0.3/1.7
Average incl sales tax			14.4 (o)	13.8		10.37 (p)	3.71 (p)					

(a) Average of all Provincial and territorial rates, weighted by population.

(b) In addition, Yukon imposes a surtax of 5% of provincial tax over \$6,000.

(c) In addition, B.C. Imposes a surtax of 30% of provincial tax between \$5,300 and \$9,000 and 50% of tax over \$9,000, reduced by a credit of \$50 per dependant.

(d) In addition, Alberta imposes a flat tax of 0.5% of taxable income and a surtax of 8% of provincial tax over \$3,500.

(e) In addition, Saskatchewan imposes a flat tax of 2% of net income and a surtax of 15% of provincial tax over \$4,000. An additional 10% surtax is applied to the aggregate of an individual's basic Saskatchewan tax and flat tax. The surtax is reduced by \$75 for single taxpayers and \$150 for those with dependants.

(f) In addition, Manitoba imposes a flat tax of 2% of net income and a surtax of 2% of net income over \$30,000 with additional offsets for the taxpayer and dependants.

(g) In addition, Ontario imposes a surtax of 20% of provincial tax between \$5,500 and \$8,000, and 30% of tax over \$8,000.

(h) Quebec levies a personal income tax directly against taxable income.

(i) New Brunswick imposes a surtax of 8% of provincial tax over \$13,500.

(j) Nova Scotia imposes a surtax of 20% of provincial tax between \$7,000 and \$10,500 and 30% on tax over \$10,500.

(k) Prince Edward Island imposes a surtax of 10% of Provincial tax over \$12,500.

(1) 55.4% is the weighted average of the basic rate in the nine provinces and two territories which have tax collection agreements with the federal government. **The average effective rate (total provincial/territorial tax, including surtaxes, flat taxes, and credits, as a percentage of basic federal tax)** for all twelve jurisdictions is 60.6%.

(m) A lower rate of 6.3 cents applies to communities not served by the highway system in the Northwest Territories.

(n) Lower rates apply to remote areas of the province.

(o) Quebec applies sales tax to fuel.

(p) Average includes provincial sales taxes of Saskatchewan, Manitoba, Ontario, Quebec, New Brunswick, Nova Scotia and Newfoundland applicable to sales of tobacco.

(q) Rates shown for health care premiums are for single individuals and families of three or more.

(r) Rates shown are for payrolls over \$400,000.

(s) Rates shown for capital tax are for large corporations and for financial institutions in the order shown. The bases are different for different type of companies.

Glossary

Accumulated debt.'

The amount by which the sum of annual deficits exceeds the sum of annual surpluses. Can also be referred to as accumulated deficit.

Accumulated surplus:

The amount by which the sum of annual surpluses exceeds annual deficits.

Basic Federal Tax:

The amount of federal income tax determined after allowing for 'non-refundable credits' (based on personal amounts, charitable contributions, etc.) that apply to both federal and provincial taxes. Provincial and territorial tax is calculated as a percentage of Basic Federal Tax.

Budget:

An estimate of the proposed expenditures for a given period (typically a fiscal year) and the proposed means of financing them (revenue estimates).

Capital spending:

Expenditures, normally not of a recurring or continuing nature, for the purchase or construction of assets such as roads, schools and hospitals, or equipment such as vehicles.

Capital tax:

Generally, any tax levied on corporations that is based on a percentage of a company's 'paid-up capital' (the book value of assets after subtracting current accounts payable).

Contribution:

A conditional transfer payment made to a group or individual for a specific purpose and which must be accounted for. These payments are a method by which the GNWT indirectly funds programs and services. An example is the contribution funding provided to Education Boards to run schools and deliver primary and secondary education in the NWT.

Deficit:

The amount by which government expenditures exceed revenues for a particular fiscal year.

Direct tax:

A tax that is assessed and collected from the persons who are intended to bear it, such as the personal income tax. In contrast, an indirect tax is one that is levied on a particular person with the intention that it should be passed on to someone else. An example of an indirect tax was the old Manufacturers Sales Tax, which was imposed on manufacturers.

Division:

A term that refers to the separation in 1999 of the NWT into two new territories, Nunavut and the Western Territory.

Envelope:

A grouping of government activities for budgeting purposes. Each envelope is comprised of government departments that provide similar functions or services.

Fiscal:

Relating to public revenues or expenditures.

Fiscal policy:

Policies relating to the expenditure and revenue collection activities of a government.

Fiscal year:

Any consecutive twelve month period designated as the budget year. The GNWT' fiscal year starts April 1 and ends March 31 of the following calendar year.

Flat tax:

A tax that is levied on income above a certain threshold at a constant marginal rate. For example, a flat tax of 2% could be levied on every dollar of income above \$5,000.

Formula Financing Agreement:

The agreement between the federal government and the GNWT that sets out the manner in which the Formula Financing Grant is made to the GNWT.

Formula Financing Grant:

The largest single revenue source for the GNWT, it is calculated by a formula that takes into account the difference between the GNWT's expenditure needs (as measured by the formula), and the government's ability to raise its own revenues.

Goods and Services Tax (GST):

A general 7% sales tax levied by the federal government on almost all goods and services.

Grant:

A payment to a group or individual without any requirement to account for how it was spent.

Income Tax Collection Agreements:

The federal-provincial-territorial agreements under which provincial and territorial income taxes are collected by the federal government. Under these agreements, all provinces and territories except Quebec agree to levy personal income taxes as a percentage of the basic federal tax and in return the federal government collects the tax on behalf of the provinces and territories. Quebec, Ontario and Alberta collect corporate income tax independently of the federal government.

Infrastructure:

Physical assets, such as airports, roads, hospitals, sewage systems, etc. that provide services to communities.

Interest:

The payment for the use of borrowed money.

Licences and user fees:

Charges imposed by governments for specific types of activities, such as driving an automobile, fishing, hunting, etc.

Mill:

As used for property tax purposes, a mill is 1/10th of a percent of the assessed value of land and improvements (such as a building).

Non-refundable tax credit:

A tax credit that can be used to reduce a taxpayer's tax liability to zero, but cannot result in a refund to a taxpayer if the amount of the credit is more than the tax payable. An example is the basic personal credit.

Operations and Maintenance (O&M) expenditures:

The Operations and Maintenance expenditures for on-going spending purposes such as wages & salaries. These expenditures are distinguished from capital spending in the GNWT's budgeting process.

Progressive tax:

A tax under which higher-income people pay a larger fraction of their income than lower-income people. An example is the personal income tax.

Refundable tax credit:

A tax credit that is used to reduce the amount of tax payable or, if no more tax is payable, is refundable to the individual as cash. An example is the NWT Cost of Living Tax Credit.

Regressive tax:

A tax under which lower-income people pay a larger fraction of their income than higher-income people.

Resource revenues:

Revenues derived from the exploitation of natural resources such as minerals, oil, gas and forests.

Revenues:

The amount of money the government collects from taxes and other fees, or receives from other governments, used to finance government services.

Royalty:

A levy imposed on the extraction of natural resources by the owner of the resource.

surplus:

The amount by which government revenues exceed expenditures for a particular year. The opposite of deficit.

surtax:

An additional tax levied on top of the tax determined in accordance with the normal tax rules. For example, Ontario levies a surtax of 20% on provincial income tax between \$5,500 and \$8,000, and 30% of tax over \$8,000.

Tax equity:

The term for tax fairness used by tax technicians. Horizontal equity requires that taxpayers in similar circumstances should pay a similar amount of tax. Vertical equity suggests that taxpayers with greater capacity to pay should pay more.

Tax Effort Adjustment Factor:

A factor used in the calculation of the Formula Financing Grant. Its purpose is to ensure that territorial revenues used in the Grant calculation are measured at national average tax rates. The effect of the Tax Effort Adjustment Factor is to penalize the GNWT for having tax rates below the national average.

Value-added tax:

A tax similar in effect to a sales tax but levied only on the value added at each stage of the production/distribution process. Also referred to as a multi-staged sales tax. The GST is a type of value-added tax.