1991 - 92 FEDERAL BUDGET

- SUMMARY AND COMMENTS -

Department of Finance

Fiscal Policy Division

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HIGHLIGHTS

OVERVIEW

The 1991-92 budget can be viewed largely as an extension of the 1990-91 budget: reductions in expenditures, insignificant tax changes and an over-riding objective of containing the deficit and the growth in the public debt.

Program expenditures are budgeted to increase faster than inflation in 1991-92: 6.9 per cent compared to forecast inflation of 5.6 per cent. This high growth rate in program expenditures is largely attributable to an increase in program expenditures in areas which are sensitive to the recession such as Unemployment Insurance benefits. Major transfers to persons are forecast to increase by close to $5 billion, or more than 13 per cent above their 1990-91 level. However, despite the recession, the growth in program expenditures is expected to be in line with growth rate in total revenues.

There are virtually no changes in taxes. The only tax change is a very large increase ($6.00 per carton) in taxes on cigarettes and other tobacco products. The other significant revenue measure is a large (24 per cent) increase in Unemployment Insurance premiums.

Expenditure controls are largely a continuation of last year's measures. With the exception of measures to control public sector wages, there are no new significant deficit reduction measures on the expenditure side affecting 1991-92.

The budget maintains and extends the reductions in major fiscal transfers to the provinces introduced in last year's budget. The freeze on total per capita EPF payments to the provinces which was to terminate at the end of the 1991-92 fiscal year is extended for a further three years as is the 5 per cent ceiling on the growth of Canada Assistance Plan payments to Ontario, Alberta and British Columbia.

Despite seven budgets which included controls in program expenditures and increases in taxes of varying severity, the federal deficit is still projected to remain over $30 billion in the next fiscal year and public debt will therefore grow to close to $420 billion. Based on the current government's past record, optimistic longer-term projections contained in this budget will meet with an understandable degree of scepticism.

Two innovative measures of widely different significance were included in this year's budget. The first is the introduction of legislated limits to spending growth. The limits to spending growth would average 3 per cent from 1991-92 to 1995-96. This is a significant departure from Canadian budget-making tradition and it would require future Ministers of Finance to amend or repeal legislation to exceed the limits to spending growth.

The second is the creation of the Debt Servicing and Reduction Fund. This fund would receive all revenues from the Goods and Services Tax and from privatization and the sums would be used to pay the interest on the national debt and to eventually repay the debt. From an accounting point of view, this is merely a notional fund: as long as the revenues from the GST ($16.4 billion in 1991-92) are lower than the costs of servicing the debt ($43.2 billion in 1991-92), the Fund will not be operative and not impose any constraint on government decision-making.

EFFECT ON THE NORTHWEST TERRITORIES

Residents of the Northwest Territories should not be affected more by this budget than residents of the rest of Canada.

Specific reductions in program expenditure do not target programs in the Northwest Territories more than those in the rest of Canada. Furthermore, the general expenditure control measures should not have a greater effect, nor should they have a lesser effect, on residents of the Northwest Territories. There will be some reductions in funding for Non Government Organizations, reductions in the growth of federal civil servants' salaries, a freeze on departmental budgets for salaries, low growth in the non transfer payment portion of federal departmental budgets, and last year's reductions in funding for public housing will be maintained. To the extent that these measures dampen economic activity and reduce the level of federal services, they should be felt equally here.

Reductions in inter-governmental transfer payments will have no direct effect on the Government of the Northwest Territories' budgetary balance. EPF and CAP payments are fully failsafed under the Formula Financing Agreement. However, the Northwest Territories already shouldered its fair share of the federal deficit reduction effort in the 1988 and 1990 revisions to the Formula Financing Agreement.

Furthermore, continued low growth in federal transfers to provinces is likely to have an indirect effect on the grant from Canada. The nature and the extent of that effect will depend on whether the provinces react to reduced federal funding through compensating expenditure reductions, increased deficits or increased taxes. Expenditure reductions would lower the Gross Expenditure Base escalator, increased deficits would have a neutral effect in the short term and increased taxes would increase the tax effort "keep-up" factor and therefore decrease the grant to the Government of the Northwest Territories.

Limited **changes to taxes** - tobacco, Unemployment Insurance premiums, some corporate tax changes - should also not have disproportionate effect on the residents of the Northwest Territories. The increase in tobacco taxes will result in higher Government of the Northwest Territories tobacco tax revenues because our tax is based on a percentage of the retail price of cigarettes, including federal taxes.

Increases in Unemployment Insurance premiums will have an effect on the expenditures of the Government of the Northwest Territories. It is expected that the premiums that the Government of the Northwest Territories is required to pay will increase by approximately $1 million per year, starting on 1 July, 1991.

Canada Mortgage and Housing Corporation funding for social housing will be lower than originally planned. Given the importance of social housing in the Northwest Territories, the continuation of a lower commitment to social housing is an area of serious concern. However, the Government of the Northwest Territories had planned for this budgetary measure and it should not affect the level of budgeted activity of the Northwest Territories Housing Corporation in 1991-92.

FEDERAL BUDGETARY BALANCE

1991-92 BUDGET: OVERVIEW

The 1991-92 federal budget forecasts the deficit and accumulated net debt as follows:

Year	Budgetary Deficit	Accumulated Net Debt
	($ billions)	
1990-91	30.5	388.5
1991-92	30.5	419.0
1992-93	24.0	443.0

The 1991-92 budget projects a budgetary deficit of $30.5 billion, the same amount currently projected for 1990-91. The 1990-91 budget deficit is $2 billion higher than the amount forecast last February by the federal Minister of Finance. This revised forecast figure has been attributed to higher than forecast interest rates, which increased debt servicing costs, and higher than forecast program expenditures.

The 1991-92 deficit represents 19 per cent of total federal expenditures, down from 20 per cent in 1990-91.

Current federal projections indicate that the deficit will be reduced to $6.5 billion by 1995-96. This projection is supported by other forecasters, based on the compounded effect of spending cuts and tax initiatives introduced over the last six years. However, the forecast is highly dependent upon assumptions about the length of the current recession and an optimistic medium-term forecast of economic growth, particularly of inflation. The 1991-92 federal budget is based on the assumption that the economy will begin to turn around in mid-1991, and that interest rates will average 9.5 per cent in 1991.

BACKGROUND

As long as the accumulated debt remains at its current high level, or continues to grow, the federal government will be fighting an uphill battle to reduce its budgetary deficit because interest charges will continue to eat up more than 30 per cent of annual revenues. Just to keep the deficit constant at $30 billion requires $3 billion in expenditure reductions or revenue increases each year to offset the increasing interest costs.

The following table shows the budgetary deficit, and the accumulated net debt since 1984-85, and compares them to national Gross Domestic Product.

	BUDGETARY DEFICIT		ACCUMULATED NET DEBT	
Year	($B)	% of GDP	($B)	% of GDP
1984-85	38.3	8.6	199.1	44.8
1985-86	34.4	7.2	233.5	48.8
1986-87	30.6	6.1	264.1	52.3
1987-88	28.0	5.1	292.2	53.1
1988-89	28.7	4.8	321.1	53.4
1989-90	29.0	4.4	351.0	54.4
1990-91(f)	30.5	4.5	388.5	57.3
1991-92(f)	30.5	4.4	419.0	59.8
1992-93(f)	24.0	3.2	443.0	59.5

The ratio of deficit and debt to GDP is commonly used to measure changes in the size of the variables relative to the size of the economy. The table indicates that the federal deficit, relative to the size of the economy as a whole, fell substantially between 1984-85 and 1989-90, partly due to federal deficit reduction measures and partly due to the growing Canadian economy. In 1990-91, the effect of the recession can be seen, as the ratio begins to rise. Federal projections of the deficit and of GDP indicate that the ratio will fall again over the next two years. This forecast is dependent on the federal assumption of economic recovery beginning in mid-1991.

Program expenditures, that is, expenditures net of debt charges, will actually be <u>less</u> than total revenues by $12.7 million in 1991-92, as they have been for the last two years. This is referred to as the "operating surplus". However, when debt charges are factored in, total budgetary expenditures exceed revenues by $30.5 million. This is referred to as the budgetary deficit.

Total Revenues	$128.5 billion
Less: Program Expenditures	115.8
Operating Surplus	$ 12.7 billion
Less: Debt Charges	43.2
Budgetary Deficit	$ 30.5 billion

THE EXPENDITURE PLAN

OVERVIEW

Total federal budgetary expenditures, including interest on the public debt, are expected to be $159.0 billion in 1991-92, an increase of 5.1 per cent from 1990-91.

Program expenditures (expenditures excluding debt charges) are forecast at $115.8 billion, and debt charges are expected to be $43.2 billion, increases of 6.9 and 0.6 per cent respectively from 1990-91.

There will be major expenditure increases in areas of unemployment insurance, agricultural subsidies, and defence. The key areas of expenditure restraint or reduction are transfers to the provinces, public service wages, job training, and grants and contributions to businesses and interest groups.

BACKGROUND

Table 1 summarizes federal spending since 1984-85.

Federal budget policy since 1984 has been to reduce expenditure growth in order to reduce the size of the budgetary deficit. The budgetary deficit is equal to total budgetary revenues minus budgetary expenditures, including debt charges. Total expenditure growth has averaged only 5.6 per cent annually between 1984-85 and 1990-91, and program expenditure growth has averaged only 3.7 per cent. Interest charges on the accumulated debt, however, grew at an average rate of 11.4 per cent per year.

Federal deficit reduction problems are due to:

1. the size of the accumulated debt, and the associated interest costs; and

2. the absolute size of federal program expenditures - $106.6 billion in 1990-91, and the fact that these expenditures are largely in areas which grow independently of federal revenues.

Allocation of Expenditures and Growth Since 1984-85

Chart 1 illustrates the distribution of federal budgetary expenditures in 1991-92. Over 27 per cent of federal spending goes toward interest payments on the accumulated debt.

More than 50 per cent of government spending, and almost 65 per cent of program expenditures, goes toward transfers to individuals (eg. Family Allowance, Old Age Security), to businesses (eg. agricultural subsidies, EDA funding) or to provincial and territorial governments (eg. Equalization, EPF, CAP, Formula Financing). Therefore, two thirds of federal program spending currently goes:

1. to "have-not" individuals and provinces;

2. to finance social programs in the provinces such as health, social assistance, and post-secondary education; or

3. to subsidize economic activity in distressed regions or industrial sectors.

These transfers have increased at an annual average rate of 4.5 per cent since 1984-85 but are forecast to grow 8.8 per cent in 1991-92.

Given the size of transfer payments relative to total government spending, it is impossible for the federal government to achieve any semblance of a balanced budget without cutting into transfer payments.

Only 13 per cent of spending, or 16 per cent of program spending, goes toward general government operations - civil service salaries, operating expenses, and so on. Growth in this area of government spending has been severely curtailed. Between 1984-85 and 1990-91, the average annual rate of growth has been only 1.2 per cent and is expected to grow only 1.1 per cent in 1991-92.

A further 8 per cent of spending goes toward defence. This amount is higher than was projected last year, due to the outbreak of war in the Persian Gulf. Defence spending has grown an average of 5.7 per cent since 1984-85, and will grow a further 5 per cent in 1991-92.

<u>Federal Expenditure Reduction Measures Since 1984-85</u>

Over the past six years, all areas of federal program expenditures have been subjected to restraint measures of one kind or another.

Transfers to persons have been restrained by means of partial de-indexation of family allowance payments, and of clawbacks of family allowance and old age security payments from higher income families.

Transfers to other governments have been affected by ceilings on equalization payments, a freeze on per capita EPF payments, a ceiling on the Formula Financing base, and other restraints on Formula Financing such as the tax effort adjustment factor.

Payments to crown corporations such as VIA Rail and the CBC have been severely restrained or cut. Foreign aid payments and defence spending have also been subject to restraint measures. The closure of a number of military bases was a major issue of the 1990 budget. Increased expenditures on defence in 1990, however, arising from

Canadian participation in the Persian Gulf, necessitated cutbacks to other areas of government spending in the fall of 1990, in order to keep total expenditures in line with targeted amounts.

Finally, cuts have been made to subsidies. The elimination of, or reduction in, funding to federal programs such as the native communications program in 1990, is one example.

Substantial reductions in growth have been made to most areas of federal spending since 1984. In the absence of the current recession, even larger reductions could have been expected for 1990-91. However, the recession has hampered, to some extent, the federal government's efforts to reduce expenditure growth, since these actions could serve to further weaken the economy in the short term. Nevertheless, substantial reductions in growth have been made to some areas of federal expenditures in 1991-92.

1991-92 BUDGET - DETAILS OF EXPENDITURE PLAN

Legislated Limits to Spending Growth

For the most part, the 1991-92 expenditure plan differs only marginally from last year's federal budget, with one significant exception. This budget proposes the introduction of legislated limits on government spending. This is a significant departure from traditional budgetary practice in Canada.

This legislation would prevent program spending from exceeding the growth rates projected in this budget. The growth rate on program spending would be restricted to an average of 3 per cent per year from 1991-92 to the end of 1995-96. If program spending in one area exceeded the prescribed projection, offsetting reductions would have to be made elsewhere. Because the limits would be placed on the cumulative growth between 1991-92 and 1995-96, overspending in one year could be offset by reduced growth in another year.

The spending limits would not be constraining in the event of a natural disaster, war or other external shock.

Such legislation, however, would always be subject to amendment by Parliament, and therefore is not absolutely binding on any government. A future government, nevertheless, would have to repeal or amend the legislation, drawing attention to the fact that it intended to exceed the spending limits.

The Expenditure Control Plan

The Expenditure Control Plan is an extension of the control measures in the 1990 budget, with some exceptions, notably the introduction of severe controls on public sector wage increases.

The measures in the control plan fall into five general categories:

1. Programs which will be exempt from controls;
2. Programs which will have their growth restrained;
3. Programs which will be frozen;
4. Programs which will face expenditure reductions; and
5. Measures to reduce spending on government operations.

1. Programs Exempt from Controls

The following programs will be exempt from controls:

- major social transfer programs such as old age security benefits, family allowances, unemployment insurance benefits, and Indian and Inuit programs;

- certain transfers to provinces such as equalization and Canada Assistance Plan transfers to equalization-receiving provinces; and

- defence.

However, social programs are already subject to clawbacks from high income families, and in the case of Family Allowance, to partial de-indexation of benefits. Equalization payments are already subject to a ceiling on growth in total entitlements equal to the growth in GNP. Indian and Inuit programs, other than those aimed at health, education, or social services were subject to a five per cent ceiling in the 1990-91 budget.

The Formula Financing Agreement will not be affected by the federal budget. The current agreement, which covers the period 1990-91 to 1994-95, has been approved by the federal Treasury Board.

Federal budget documents indicate an increase in funding to the territorial government in 1991-92 of $87.3 million. Of this the Government of the Northwest Territories will receive $59 million. This increase results from the application of the formula, and does not involve any special incremental funding to the Government of the Northwest Territories. This amount represents an increase of 8 per cent in the Formula Financing Grant. It also does not include $24 million in additional funding in 1991-92 accruing from the transfer of the Arctic B and C Airports and Highways Programs.

Furthermore, since 1988, a number of changes have been made to the formula by the federal government. If these changes had not been made, federal funding to the Government of the Northwest Territories would be $126 million higher over the five years of the new Agreement.

2. Programs Subject to Expenditure Ceilings

CAP transfers to non-equalization-receiving provinces (Ontario, Alberta, and BC) will be limited to annual growth of 5 per cent until 1994-95. This is an extension of the measure which was introduced in 1990 for two years. This measure will not affect the Northwest Territories.

Growth in science and technology programs and cash foreign aid payments will be subject to a 3 per cent ceiling.

3. Program Spending which will be Frozen

The following programs will remain frozen:

- per capita EPF entitlements;
- payments under the Public Utilities Income Tax Transfer Act (see Revenue briefing for discussion of this item);
- payments to Telefilm Canada and concessional loan financing of the Export Development Corporation (these latter items will not affect the NWT).

Per capita financing under the EPF program will continue to be frozen at 1989-90 levels. This is a continuation of a measure introduced in the 1990 budget. Total entitlements to a province or territory may increase as population increases, but they will not be indexed to the increase in GNP, as they were before 1990. This measure will affect EPF payments to the GNWT, but because EPF is failsafed 100 per cent under Formula Financing, there will be no net effect on overall GNWT revenues.

However, if provinces react to the federal cuts by increasing their tax effort, or decreasing expenditure growth, there could be an indirect effect on the grant. If provinces increase their own tax effort, in response to lower federal transfers, this will result in a higher "keep-up" factor under Formula Financing, and, therefore in lower growth in the grant. If provinces respond by reducing their own expenditure growth, the provincial-local expenditure (P-L) escalator will be reduced. If the P-L escalator is lower than the GDP ceiling, this will mean reduced growth in the grant. If the GDP ceiling remains in effect, however, reduced provincial spending growth will not have an immediate impact on the grant. Finally, if provinces react to reduced federal funding growth by increasing their deficits, there will be no immediate effect on the grant. However, in the longer-term, as provinces have to reduce expenditure growth or increase tax effort to finance the increased debt, the effect will be felt in lower funding growth to the Government of the Northwest Territories.

Provinces have protested cutbacks to EPF, claiming that they jeopardize their ability to provide services, particulary health services, which comply with national standards. The Canada Health Act authorizes the federal government to withhold EPF cash payments from any province not in compliance with national standards and criteria. Given the restraints imposed on EPF, some provinces' cash payments will eventually disappear, leaving them with only the tax point transfer from EPF. This may make it more difficult to enforce national standards, as the federal government would not have any leverage. The federal government is now proposing to amend the Fiscal Arrangements Act so that, if necessary, other cash transfers to provinces (under equalization, or other programs) could be withheld for purposes of enforcement.

4. Programs Subject to Funding Reductions

Total grants and contributions, largely to businesses and interest groups, not explicitly covered elsewhere in the Expenditure Control Plan will be reduced by $75 million in 1991-92 and $125 million each year thereafter through 1995-96. The budget document states that grants to Indian and Inuit peoples will be exempt, however there are exceptions to this.

Funding to aboriginal political organizations under the Secretary of State has been reduced 10 per cent in 1991-92. This follow a 20 per cent cut to funding for these groups in 1990-91. Examples of organizations in the Northwest Territories affected by these cuts are the Dene Nation, the Inuit Tapirisat, and the Metis Association.

Budget documents also show the elimination of $2.7 million in funding to the Government of the Northwest Territories for the preservation and development of aboriginal languages. However, funding for this program was part of a five-year agreement with the federal government. This agreement was extended for one additional year, and expires on March 31, 1991. Negotiations between the Government of the Northwest Territories and the federal government are currently underway to renew the agreement. It is expected that additional funding for 1991-92 will be forthcoming when the new agreement is finalized.

Canada Mortgage and Housing Corporation (CMHC) funding for new social housing will be reduced by 15 per cent relative to planned levels. This measure is a continuation of a measure introduced in the 1990 budget. The Northwest Territories Housing Corporation should not be further affected by this cut, since the measure implemented last year was incorporated into the NWTHC's budgets for 1990-91 and 1991-92.

Grants and contributions under for the Canadian Jobs Strategy Program will be reduced by $100 million in 1991-92. This program provides funding for job-oriented training. In 1990-91, Arctic College received $3.72 million under the program, in the form of contracts from third parties, to provide training. The Government of the Northwest Territories also expects to enter into a cost-sharing agreement with the federal government under this program to provide employment training for social assistance recipients. It is not known at this time whether this agreement will be affected by the cuts to this program. Total federal funding available under the agreement in 1991-92 is expected to be $750,000. The 1991-92 federal budget includes a total of $1.47 billion for grants and contributions under this program. The budget documents do not show a regional breakdown of spending in 1991-92.

Funding for the Green Plan of $3 billion over the 1991-92 to 1995-96 period will be stretched out one additional year, to 1996-97. Implementation by Indian and Northern Affairs of the Arctic Environmental Strategy is one component of the Green Plan. The Arctic Environmental Strategy is a $100 million, five-year program to address issues such as waste clean up, water quality, and toxic contaminants in food. DIAND is still awaiting clarification of changes to the Green Plan, and how they will affect environmental programs administered by the department.

DIAND has also announced that funding for the Northern Land Use Planning Program will cease as of April 1, 1991. This change is not reflected in the department's 1991-92 Main Estimates. The land use planning process is linked to the settlement of land claims. Three plans currently in progress - the Mackenzie Delta/Beaufort Sea plan, the Keewatin plan, and the Sahtu plan - are to finalized by September. DIAND has spent about $4 to $5 million annually on this program. Its cancellation will have implications for the land claims process.

5. Controls on Government Operations

Spending on government operations increased an average of only 1.2 per cent between 1984-85 and 1990-91. The 1991-92 budget sets out a number of new initiatives intended to further control spending on government operations. These measures will have the following implications:

- Public sector wage increases will be limited to 3 per cent per year for the next three years. If the government cannot successfully negotiate these settlements with public sector unions, the limits will be imposed by legislation, and public sector strikes will be ended by legislation.

- Furthermore, there will be no increase in departmental salary budgets in 1991-92 to compensate for wage settlements, and there will be a maximum increase of 3 per cent in departmental budgets in 1992-93 and 1993-94. This means that wage and salary increases resulting from the collective bargaining process will have to be funded through a corresponding reduction in public service employment. The budget estimates that there could be up to 6,000 public sector jobs lost as a result of this measure. It is not possible at this time to determine where these cuts will be made. There are about 1,600 federal public servants in the Northwest Territories.

- The DIAND Main Estimates show a decrease of 232 person years from 1990-91 to 1991-92. However, this reduction is the result of the transfer of these jobs to native bands in southern Canada. The bulk of these positions are teaching positions.

- There will be a 10 per cent reduction in the number of executives in government. Wage increases for the management category in the next three years will be no higher than the average of federal public sector negotiated settlements. A minimum of 475 jobs will be eliminated.

- The non-wage operating and capital budget of the government will be frozen for 1991-92, followed by tight constraints thereafter.

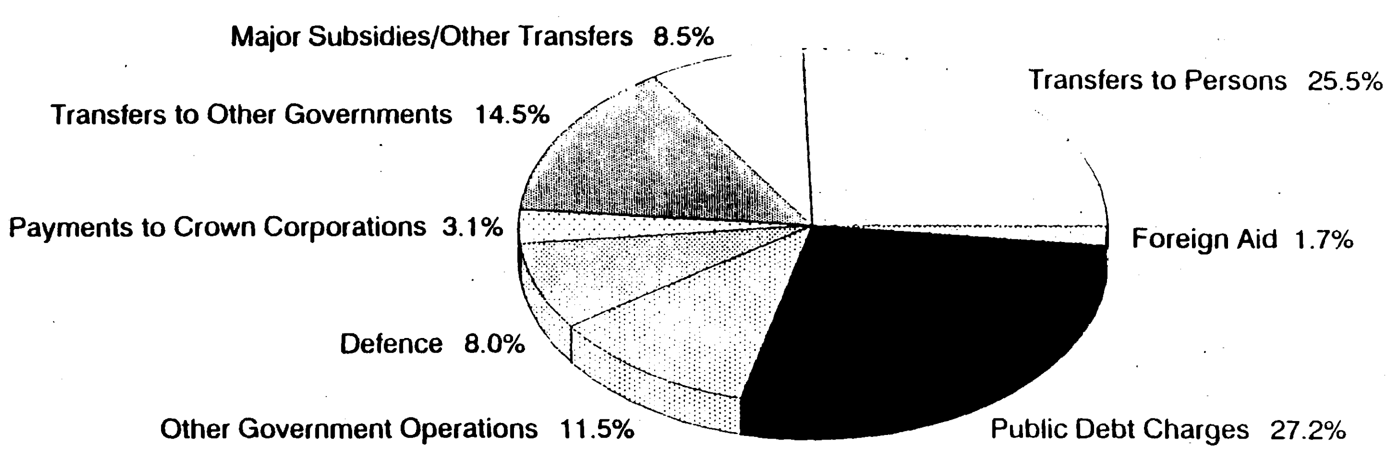
- Other management and efficiency initiatives will be taken, including the privatization of Crown Corporations such as PetroCanada and Telesat Canada. The Canada Oil and Gas Lands Administration (COGLA) will be disbanded and its responsibilities transferred to other departments. As COGLA administers oil and gas resources in the NWT, its disbanding will have repercussions for the NWT. At this time the federal government has not decided which departments, or organizational structures, will undertake COGLA's responsibilities.

These measures are expected to save the government $3.6 billion over the next five years, or an average of slightly more than $700 million a year. This is an indication of the comparatively small proportion government operations represent in total government spending, and the fact that it is relatively difficult, despite quite drastic measures, to realize large savings in this area.

TABLE 1
FEDERAL GOVERNMENT EXPENDITURE GROWTH
1984-85 TO 1992-93

EXPENDITURE CATEGORY	ANNUAL EXPENDITURES (billions of dollars) 1984-85	1990-91	1991-92	1992-93	RATES OF INCREASE (per cent) Average Annual Increase 1984-85 to 1990-91	Annual Increase 1990-91 to 1991-92	Annual Increase 1991-92 to 1992-93
Transfers to Persons	25.1	35.8	40.5	41.5	6.1	13.1	2.5
Transfers to Other Governments	18.8	23.3	23.1	23.6	3.6	(0.9)	2.2
Major Subsidies/Other Transfers	10.7	11.8	13.6	12.8	1.6	15.3	(5.9)
Crown Corporations	4.8	4.9	4.8	4.8	0.3	(2.0)	0.0
Defence	8.7	12.1	12.7	12.8	5.7	5.0	0.8
Foreign Aid	2.1	2.6	2.8	2.8	3.6	7.7	0.0
Government Operations	16.8	18.0	18.2	19.6	1.2	1.1	7.7
Reserves net of Lapse			0.2	1.7			
Total Program Spending	87.1	108.3	115.8	119.7	3.7	6.9	3.2
Public Debt Charges	22.5	43.0	43.2	44.0	11.4	0.6	1.9
Total Spending	109.8	151.3	159.0	163.6	5.6	5.1	2.8

Chart 1
Federal Budgetary Expenditures
1991 - 92



Source: 1991 Federal Budget

REVENUES

OVERVIEW

Table 2 tracks the revenues from major federal taxes over the period 1987-88 to 1992-93. Total revenues, including GST, are expected to be $128.5 billion in 1991-92, an increase of 6.4 per cent over 1990-91. Total revenues will increase by a further 8.6 per cent in 1992-93 to $139.6 billion.

In 1991-92, personal income tax revenues are projected to increase by 8.7 per cent while corporate income taxes are expected to decline by 3.5 per cent, reflecting the slowdown in economic activity. Unemployment insurance contributions will increase by 20.9 per cent in 1991-92, reflecting the increase in contribution rates by employees and employers announced in the budget.

Revenues from the Goods and Services Tax are projected to be at $16.4 billion in 1991-92 and $18.2 billion in 1992-93. This estimate is lower than what the federal government was projecting in December 1989, despite statements by federal politicians including the federal Minister of Revenue that the GST may yield revenues in excess of expectations.

Revenues from sales and excise taxes, excluding the GST, are projected to increase by 8.8 per cent, in 1992-93 reflecting in part the increase of 3 cents per cigarette in the cigarette excise tax announced in the budget. This measure is estimated to increase federal revenues by $1.4 billion in 1991-92 and $1.1 billion in 1992-93. Despite this increase, revenues from sales and excise taxes for 1990-91, including the GST, estimated at $26.8 billion, are lower than estimated in the 1990 federal budget ($28.2 billion).

Table 2

Federal Budgetary Revenue 1987-88 to 1992-93
($ Millions)

	1987-88	1988-89	1989-90	1990-91 (est)	1991-92 (est)	1992-93 (est)
Personal Income Tax	45,125	46,026	51,895	59,075	64,190	68,970
Corporate Income Tax	10,878	11,730	13,021	11,400	11,000	12,300
U.I. Contributions	10,425	11,268	10,738	12,685	15,330	17,945
Goods & Services Tax	0	0	0	1,820	16,350	18,260
Sales & Excise Taxes/Duties (includes MST)	23,009	25,668	28,097	24,965	11,600	12,625
Sales, Excise Taxes/Duties	23,009	25,668	28,097	26,785	27,950	30,885
Other revenues	8,015	9,289	9,955	10,805	10,030	9,500
Total Budgetary Revenues	97,452	103,981	113,706	120,750	128,500	139,600

Sources: Public Accounts of Canada and federal budget for estimates

Chart 2 depicts the projected shares of the major federal taxes for 1991-92.

PERSONAL INCOME TAX

Over the term of the current government, personal income taxes have grown from $32.9 billion, or 42.1 per cent of budgetary revenues in 1985-86 to a projected $64.2 billion, or 49.8 per cent of budgetary revenues in 1991-92. Although tax reform in 1988 reduced the personal income tax burden, other changes to the personal income tax system since 1984 have contributed to increasing the proportion of federal revenues coming from individual income taxes.

The most significant of these changes was the limiting of the indexing of the personal income tax brackets, deductions and credits to the increase in the Consumer Price Index in excess of three per cent. Some other deductions, such as the northern residents deduction, are not indexed and have lost value since their introduction.

There were no significant changes to personal income taxes in this budget, but several small changes were announced which will likely not have a significant revenue impact.

a) The disability tax credit will increase from $575 to $700 in 1991. The budget also proposes clarification to the definition of disabled which might restrict access to the deduction.

b) Numerous expenses paid after 1990 will be eligible for the medical expense tax credit.

c) Changes will be made to the $500,000 Capital Gains exemption for shares in small businesses to allow owners taking their small business public to take advantage of the exemption.

The budget proposes to change the manner in which lump sum disability payments from the Canada and Quebec Pension Plans are subject to income tax. At present, the payments are taxed in the year of receipt, even though they may relate to prior years. As a result, because of the progressive tax system, the tax liability of recipients can be much higher than if the benefits were taxed on an ongoing basis from the date of eligibility.

With respect to disability benefits received in 1991 and subsequent taxation years, the amount will be spread over the years in respect of which they were paid.

CORPORATE INCOME TAX

Over the past few years, provinces have increasingly used capital and payroll taxes to raise revenue. One advantage of such taxes for provincial governments is that they are deductible by corporations for purposes of federal income taxes. Because of this deduction, the federal government effectively shares in the cost of payroll and capital taxes. In addition, the federal government has been paying payroll taxes based on salaries paid to its own employees.

In the budget, the government proposes to continue to pay provincial payroll taxes. However, it has indicated that it will limit the deductibility for income tax purposes of provincial capital and payroll taxes. Once the new system is fully phased in:

Companies or groups of related companies will only be able to deduct the first $10,000 of provincial capital and payroll taxes.

A new tax deduction, equal to six per cent of a corporation's income, less $10,000, will also be phased in. The combination of this deduction with the limit on the deduction for payroll and capital taxes is anticipated to be revenue neutral. The deductions should work as follows:

	Current System	Proposed System
Payroll and Capital Taxes	$ 100,000	$ 100,000
Income before taxes	$1,000,000	$1,000,000
Payroll and Capital tax deduction	$ 100,000	$ 10,000
Offsetting Tax allowance (6 per cent of Taxable Income, less $10,000)	-	$ 50,000
Taxable Income	$ 900,000	$ 940,000
Tax (at 40 per cent)	$ 360,000	$ 376,000

The proposal would be phased in over the next three years, becoming fully operational in 1994.

The NWT does not have a payroll tax or a capital tax, so the elimination of the deduction for these taxes will not affect most corporate taxpayers in the NWT. The new deduction of six per cent of income will, however, reduce the taxable income and tax paid by Northwest Territories corporations.

Although the deduction will reduce the amount of NWT corporate income tax received, most of the reduction in tax will be offset by an increase to the grant.

Public Utilities Income Tax

Prior to 1990, the federal government refunded to provinces and territories 95 per cent of the federal income tax paid by utility companies. This refund was intended to put provinces with privately owned utilities on the same basis as those with government owned utilities, which do not pay federal income tax.

In the 1990 budget, the amount of this refund was frozen for two years at 1989-90 levels. The 1991 budget extends this freeze until 1995-96. In 1989-90, a total of $279 million was paid under this program, of which $200 thousand was received by the GNWT. Alberta and Ontario receive the most under this program.

The Government of the Northwest Territories refunds its rebate to power consumers through the two privately owned utility companies. While the freezing of this program will not directly affect the Government of the Northwest Territories, it will affect the amount of the rebate available to consumers.

TOBACCO TAXES

In the budget, it is proposed that the excise tax on cigarettes be increased by 3 cents per cigarette, or $6 per carton, increasing total federal excise taxes and excise duty from $9.85 per carton to $15.85 per carton. This increase will be subject to GST, adding another 42 cents to a carton of cigarettes. Similar increases were proposed for cigars and other manufactured tobacco products. In addition, a new rate of 5.4 cents will apply to pre-proportioned tobacco sticks, which were previously taxed at the same rate as fine cut tobacco. As a result, tobacco sticks and other cut tobacco products will be taxed at about 2/3 of the rate of cigarettes.

Federal tobacco taxes in Canada remained stable over the 35 years before 1980. The tax was only 1.1 cents per cigarette in early 1980, compared to 1.0 cents in 1945 and 1.15 cents in 1952. Since 1980, however, taxes on cigarettes have increased substantially in response to public pressure and health concerns. Federal taxes have increased over 600 per cent since 1980.

The Northwest Territories and several other jurisdictions base their tobacco taxes on the retail price. The increase in price of six dollars per carton will lead to an increase in the amount of tax collected by the Northwest Territories. The combined effect of these two tax increases, based on past history should reduce consumption by over ten per cent.

The effect of the federal tax increase on the price is shown below.

	Pre-Budget January 1	Post Budget February 27
Price, excluding taxes[1]	$10.10	$10.65
Excise Tax	$ 4.35	$10.35
Excise Duty	$ 5.50	$ 5.50
NWT Tax	$13.40	$13.40
Subtotal	$33.35	$39.90
GST	$ 2.33	$ 2.80
Total Price	$35.68	$42.70

OTHER

Debt Servicing and Reduction Fund

The federal government is proposing to establish a separate Debt Servicing and Reduction Fund. Legislation will provide that all revenues from the Goods and Services Tax, along with revenues from privatization and debt reduction contributions from the public, will be credited to the Fund and the only expenditure allocated to the Fund will be public debt interest charges. The fund will be audited annually by the Auditor General.

The Fund is merely a notional fund. As the budget documents themselves admit, GST revenues are, and will continue to be for the foreseeable future, insufficient to cover the public debt interest payments. For 1991-92, GST revenues are estimated to be $16.4 billion and public debt interest $43.2 billion. By 1995-96, net GST revenue is forecast to be $22 billion and public debt interest to be $43.4 billion. The Fund could only become meaningful once GST revenues exceed public debt interest charges.

From a political perspective, the fact that this Fund will be governed by legislation makes it somewhat more difficult for a subsequent government to attempt to use the GST as a "cash cow" for increasing program spending. However, at current levels of debt servicing costs, GST revenues would have to at least double before this would happen.

Tax on Taxable Income

Most provincial and territorial governments have over the past few years been requesting that they be allowed to base their personal income tax rates on taxable income, instead of on Basic Federal Tax as is now the case. Until now, the federal Finance Department has resisted this idea because it would complicate returns, and possibility lead to a more fragmented tax system if different provinces were to allow different credits or levels of progressivity. Because the provinces and territories have income tax collection agreements with Canada, they cannot change the way they impose personal income taxes unless they either obtain federal agreement or withdraw from the collection agreement and collect their own tax.

Alberta and British Columbia have indicated that in the absence of federal agreement, they were considering setting up a joint provincial personal income tax collection system, which would allow them more flexibility.

In the budget address, it was announced that a discussion paper on the topic will be released in the spring, and that the federal government would seek the advice of Canadians and tax professionals. This confirms the announcement of the federal Finance Minister at the January meeting of Finance Ministers in Toronto.

Pension Investments in Equities

Under the current income tax rules, equities held by individuals are not taxed at the same rate as debt, because of the Dividend Tax Credit and partial taxation of capital gains. These provisions partially offset the double taxation of corporate income - once in the hands of the corporation and once in the hands of the shareholder.

These benefits are not available to pension plans. Because of this, Canadian pension fund managers may be more likely to invest in debt instead of equities than managers of pension funds abroad.

In the budget, the government has suggested that pension funds could receive an annual credit for one per cent of the value of Canadian equities in their portfolios and pay a levy of half a per cent on the value of other investments, in order to reduce distortions in pension fund behaviour. The provision could encourage pension funds to invest in Canadian stocks.

The government has proposed to produce a discussion paper this spring as a basis for consultations with the investment community and pension plans.

Increases to Unemployment Insurance Premiums

The budget proposes to increase unemployment insurance premiums for employees from $2.25 per $100 of insurable earnings to $2.80 per $100. The rate for employers will increase from the current $3.15 per $100 to $3.92 per $100. For an employee earning at the maximum insurable earnings of $680 per week annual unemployment insurance contributions will increase to $990.08 from the current $795.60. The maximum employer contribution increases to $1386.11 from $1113.84. This change will take effect on July 1, 1991.

The federal fiscal plan calls for unemployment insurance contributions to increase from $12.7 billion in 1990-91 to $15.3 billion in 1991-92 and $17.9 billion in 1992-93.

Unemployment insurance contribution rates were set at their current levels in 1990 as part of a restructuring to provide more training, remove work disincentives and to make the Unemployment Insurance Fund self-financing. The levels were set for a three year period to 1992.

At existing contribution rates, the federal government is now projecting the Fund to go into deficit of about $6 billion by the end of 1992, primarily as a result of higher than expected unemployment levels because of the recession and economic slowdown.

Legislation will be introduced to empower the Employment and Immigration Commission to set rates for 1992. The budget documents do not indicate whether this arrangement would continue for years subsequent to 1992, although it is likely.

Employees and employers in the Northwest Territories will face higher premiums as a result of this measure. The impact on employees will be to reduce take-home pay. An NWT employee earning at the 1991 maximum insurable earnings level of $680 per week would pay an additional $3.74 per week under the proposal. Since unemployment insurance contributions are tax creditable, the after tax cost to the employee would be an additional $2.82 a week.

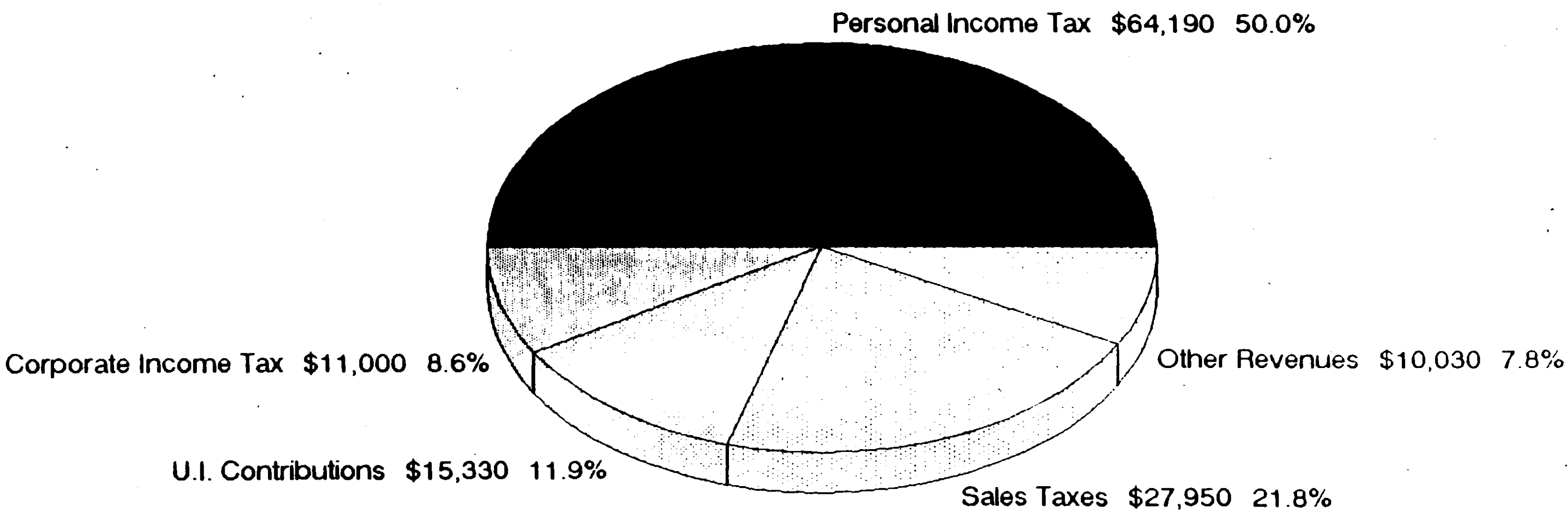
A total of about $2.6 million in additional premiums will be paid by employees in the Northwest Territories in 1992 as a result of this change.

For employers, the additional premiums will increase the cost of doing business and is in addition to other costs facing employers. Contributions are tax deductible for corporate tax purposes.

The change will cost the Government of the Northwest Territories about $750,000 in 1991-92 and over $1 million in 1992-93 in increased employer premiums.

Since Unemployment Insurance premiums are deductible for both personal and corporate income tax purposes, there will be an impact on the revenues of the GNWT as a result, although this impact is expected to be small.

Chart 2
Federal Budgetary Revenue
1991 - 92



Source: 1991 Federal Budget